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General exceptions and police powers doctrine in indirect expropriation

Master's Thesis

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LIST OF ABBREVIATIONS

ABBREVIATION	MEANING
Art.	Article
ASEAN	Association of South East Asian Nations
BIT	Bilateral Investment Treaty
CEPA	Comprehensive Economic Partnership Agreement
e.g.	For Example (*exampli gratia*)
ECHR	European Court of Human Rights
ESC	Essential Security Clauses
Et seq.	And following (*et sequens*)
FTA	Free Trade Agreement
GEC/GECs	General Exceptions Clauses
i.e.	In other words (*id est*)
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
IIA/IIAs	International investment agreement
ISDS	Investor-state Dispute Settlement
IUSCT	Iran-US States Claims Tribunal
LCIA	The London Court of International Arbitration
NAFTA	North American Free Trade Agreement
No.	Number
OECD	Organisation for Economic Co-Operation and Development
p./pp.	Page/Pages
para./paras.	Paragraph/Paragraphs
PCA	Permanent Court of Arbitration
PCIJ	Permanent Court of International Justice
SCC	Stockholm Chamber of Commerce
State	The host state in a state-foreign investor relationship
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
v.	Against (versus)

INTRODUCTION

In the contemporary increasingly globalized world, an aggregate of divergent interconnected rights of miscellaneous entities is always in a need of searching for a perfect internal balance among these rights.

The same applies within the ambit of international investment law which has recently found itself in a desperate need of recalibration of the private and public rights.

As a matter of fact, the investor's protection, especially in the context of (indirect) expropriation, has grown into a sophisticated and strong tool represented by a network of countless IIAs. However, as it turned out, such practice had an unpleasant side effect, which lies in erosion of the state's flexibility in performing its regulatory powers. Some of the scholars or commentators referred to this course of events as a "regulatory chill" or "regulatory freeze" which concerns the situations when the states are reluctant to adopt necessary welfare policies due to concerns of the prospective claims brought by investors on the grounds of indirect expropriation allegations.[1]

Since in a modern international law the states as sovereigns must fulfil their obligations to maintain sustainable development, protect and preserve public order and health as well as act in accordance with other commitments within international relations, the problem of reduced regulatory flexibility can have unexpected repercussions in many different areas such as environment protection or human rights.[2]

Followingly, as has been expressed by *prof. Crawford*, the need to balance the rights of investors and states in the frames of the investment protection is currently "*one of the most significant challenges facing international investment law*".[3]

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[1] SHEKHAR, Satwik. Regulatory Chill: Taking the Right to Regulate for a Spin. Indian Institute of Foreign Trade: Centre for WTO Studies. 2016, Working Paper CWS/WP/200/27. P. 13-15.

[2] Precisely as regards the human rights, in 2008 *prof. John Ruggie,* in the *Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprise*s, has expressed, besides other things, his concerns about the status of transnational corporations as follows: "*their legal rights have been expanded significantly over the past generation. This has encouraged investment and trade flows, but it has also created instances of imbalances between firms and States that may be detrimental to human rights*." [in para. 12.]

[3] CRAWFORD, James. Chapter 27: The Kyoto Protocol in Investor-State Arbitration: Reconciling Climate Change and Investment Protection Objectives. In: SEGGER, Marie-Claire, GEHRING, Markus W. and NEWCOMBE, Andrew. *Sustainable development in world investment law*. Alphen aan den Rijn : Kluwer Law International, 2011. P. 686.

More precisely, as regards the investors' protection under the notion of indirect expropriation, the current problem in international investment arbitration practice is to find the scope of a taking against which the law gives effective protection but on the other hand does not take too much from the regulatory flexibility of states.[4]

Hence, the foregoing boils down to the fact that in the prospective investor-state disputes the investment tribunals will primarily have to deal not with the question whether the expropriation was lawful but whether there was any in the first place. Since, in the current situation, to do otherwise would be "*putting the cart before the horse*".[5]

[4] SORNARAJAH, Muthucumaraswamy *The International Law on Foreign Investment*. 3rd ed. New York : Cambridge University Press, 2010. P. 363.

[5] *Fireman's Fund Insurance Company v. Mexico*, ICSID case No. ARB(AF)/02/1, Award, 17 July 2006, para. 174.

METHODOLOGY

1. RESEARCH QUESTION

To the date, 3285 international investment agreements have been concluded while on the basis of some of them a total of 983 disputes have been brought before the investment tribunals within the ambit of international investment law.[6]

Although more than half of these disputes revolved around allegations of indirect expropriation, and one would assume that the matter has already been exhaustively resolved, the opposite is true.[7] The concept of indirect expropriation is still far from a clearly understood institute while the approach thereto both in practice of the investment tribunals and IIAs leaves much to be desired.

It is precisely the drafting of IIAs where the most problematic issues concerning the concept of indirect expropriation have their roots. The point is that there is a wide range of different wordings of expropriation clauses where the terminology related to the matter is being addressed with a great portion of creativity. These clauses do address individual forms of expropriation (i.e. direct, indirect, tantamount to, etc.), however, not all of them mention indirect expropriation. What is more, while these forms might be listed in the expropriation clauses of IIAs, there usually is a lack of guidelines that would indicate how to treat the concept of these different types of expropriation (especially indirect expropriation) in case the dispute arises between a state and an investor. To put the record straight, over the last few decades the practice of drafting IIAs has indeed gone through several important changes. However, as it goes for the method of trial and error, the changes and re-wordings mostly concerned those IIAs under which the investment claims were brought before international tribunals.

Another aggravating issue is also the very heterogeneous terminology, which mainly concerns indirect expropriation, especially its individual subcategories.[8] One can also encounter formulations such as "tantamount to expropriation" or "equivalent to" expropriation, which in

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[6] ANON., 2019. Home | UNCTAD Investment Policy Hub. Investmentpolicy.unctad.org [online] [accessed. 3 . December 2019]. Retrieved z: https://investmentpolicy.unctad.org/

[7] DOLZER, Rudolf. Indirect expropriations: new developments. *New York University Environmental Law Journal*. 2002, 11(1), 64-93. P. 68.

[8] References are often being made to de facto, disguised, creeping or consequential, constructive, regulatory or virtual expropriation, and other forms basically referring to the same situation.

itself is a very vague concept and requires further specification which, for the time being, the tribunals failed to unanimously agree upon.

Furthermore, the above mentioned has directly contributed to the inconsistency in the decisions of the investment tribunals. It is true, as will also be shown further, that many tribunals agreed on plentiful aspects of indirect expropriation and other concepts discussed in this thesis. Nevertheless, it is also true that miscellaneous questions have yet to be resolved (and preferably as soon as possible).

Finally, in the process of the development of indirect expropriation the states' inherent power to regulate started to be oppressed by the protection of foreign investors. In fact, "*failure of some arbitral tribunals to […] allow States a sufficient margin to determine and implement various policy goals, has contributed to the legitimacy crisis in which the investment treaty system currently finds itself*."[9]

As a consequence, the states have with an increasing tendency begun to include into IIAs specific arrangements to reaffirm and secure their regulatory powers. This not only gave rise to inclusion of very detailed interpretation annexes to the "expropriation clauses", but also triggered the practice of incorporation the so-called "general exceptions clauses" into IIAs which are the ultimate tool supposed to protect the state's regulatory flexibility.

In view of the above, this thesis will ruminate on the foregoing and answer the following questions.

(i) Which method shall be applied by international investment tribunals in the scrutiny of the challenged state's measures in cases of indirect expropriation?
(ii) What are the possible means the states can utilize in pursuance of recalibration of the relationship between their regulatory flexibility and investors' protection?
(iii) Do the GECs have any practical applicability within the ambit of international investment law?

Before diving into the discussion over the outlined questions, it bears emphasizing that the concept of indirect expropriation and its relationship with the state's right to regulate is a very complex and complicated topic. Hence, for the purpose of this thesis only several aspects thereof will be addressed as otherwise this paper would turn into a never-ending story. The aim

[9] SHIRLOW, Esmé. Deference and Indirect Expropriation Analysis in International Investment Law: Observations on Current Approaches and Frameworks for Future Analysis. *ICSID Review*. 2014, 29 (3), pp. 595–626. P. 595.

is thus to provide a reader with a "*hitchhiker's guide*" through the concept of indirect expropriation in the context of the state's police powers.

2. SOURCES AND METHOD

In pursuance of the answers to the foregoing research questions, the analysis of this thesis proceeds from both primary and secondary sources. Most of all, these are:

(i) case law;

(ii) IIAs and other international legal documents; and

(iii) miscellaneous scholarly works.

Since especially the last Part of the thesis relates to the phenomenon of the general exceptions clauses which is a considerably novel topic introduced to the area of international investment law though IIAs, this Part will mostly rely on the current treaty practice and thus draw mostly upon the case law and IIAs.

As concerns the methodology, there are several methods applied correspondingly with the research questions outlined above as well as the structure of the thesis. Firstly, the method of conceptual analysis is applied in the Parts which are dedicated to the analysis of the existing conceptual framework of the respective institutes subjected to the scrutiny therein.

In the following, the method of analysis is applied to the individual cases while particular reasonings of the investment tribunals are subjected to the method of synthesis. Accordingly, IIAs are scrutinized under a method of analysis as well as the comparative method mostly applied to the study of the respective treaty wordings.

Additionally, the method of analysis applied to the case law and IIAs is both the quantitative and qualitative; qualitative as regards the scrutiny of individual reasonings and wordings of IIAs, quantitative as concerns the analysed data on the types of cases decided, their outcomes, IIAs signed and a general representation of certain wording throughout different treaties.

3. STRUCTURE OF THE THESIS

The structure of this thesis consists of six Parts: an introductory section, four substantive sections and a conclusion.

An introductory section sets forth the main idea of the thesis and the research questions which are to be dealt with therethroughout. Additionally, it determines the sources used and methodology applied in order to provide with the answers to the established research questions.

Followingly, the thesis proceeds with the substantive section. This consists of four closely thematically interrelated Parts; the first providing with the general underpinning theoretical background, the latter three successively dealing with each and individual phenomenon set forth in the beginning of the thesis.

For the sake of greater clarity, each Part of the thesis is outlined in a similar manner: first is the descriptive section introducing the topic and providing with the discussion on principal issues related thereto, second and third revolving around the treaty practice and jurisprudence concerning the respective phenomenon. The latter emerges from the fact that each of the concepts discussed made its way into IIAs in a variety of forms which in turn, jointly with the different doctrinal and legal background of the respective investment tribunals, caused inconsistencies of opinion in the decision-making practice of the ISDS.

Hence, the first (I) Part termed "Expropriation" generally introduces the main characteristics of expropriation within the ambit of international investment law, by which it sets forth the terminological and doctrinal background to better navigate the reader through the following Parts.

The second (II) Part termed "Indirect Expropriation" revolves around the issues related to the assessment of the cases based on the allegations of indirect expropriation. It also touches upon the issues of balancing the protections of the investors' proprietary rights and the states' police powers which is then taken up by the third Part. The purpose of this Part is to generally delineate the issues related to the concept of indirect expropriation and to ruminate over the essential issues related to the matter which provide the subsequent Parts with certain terminological frames.

The third (III) Part termed "Right to Regulate and Indirect Expropriation" follows with the thorough discussion regarding the state's sovereign right to regulate its internal matter. It mostly focuses on the collision of the police powers and investors' protection within the ambit of international investment law.

The fourth (IV) Part termed “General Exceptions” introduces one of the means of incorporating the aforementioned police powers into the wordings of IIAs. As for the fact that this practice is considerably new for the international investment law, this part also outlines several issues that have not been resolved yet but might later cause difficulties in application within the ISDS practice.

Finally, the conclusion summarizes and integrates all the foregoing issues discussed in the thesis. Additionally, it aspires to provide certain guidelines for a complex solution based on the recalibration of the relationship of public and private rights within the ambit of international investment law which is currently volatile.

EXPROPRIATION

1. EXPROPRIATION IN INTERNATIONAL INVESTMENT LAW

In international law, the states as sovereigns have in principle right of taking of any property located at their territories including the possessions of foreign investors.[10] This is also partly linked to the general entitlement of the states to regulate as sometimes adopting new laws can have an expropriatory effect on foreign investment. However, the possibility to lawfully take over the foreign property is not unlimited as states can only do so in a non-discriminatory way, for a public purpose, and on payment of prompt and adequate compensation[11].[12]

The aforesaid takings are jointly referred to as expropriation which, in the terms of international investment law, can be simply defined as taking by the host state of a foreign investor's rights or properties.[13] Unlike nationalization, which refers to large-scale takings of the property in all economic sectors or the industry, expropriation typically refers to property-specific takings.[14]

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[10] SCHREUER, Christoph. The Concept of Expropriation under the ETC and other Investment Protection Treaties. Transnational Dispute Management (TDM) [online]. 1 June 2005, 2.3. [Accessed 20 June 2019]. Available at https://www.transnational-dispute-management.com/article.asp?key=467. P. 2, para. 1.

[11] The so-called Hull formula which is still the best-known definition of the compensation standard as well as the most extensive one in scope. The formula was introduced by the United States Secretary of State Cordell Hull, who in 1938, upon the expropriation of United States property in Mexico, required *"prompt, adequate and effective compensation"*.
See in KADIR, M. Ya'kub Aiyub. Hull Formula and Standard of Compensation for Expropriation in Postcolonial States. *Kanun: Jurnal Ilmu Hukum* [online]. 29 May 2017, 19(2), 231-248, p. 235 [Accessed 20 June 2019]. ISSN 2527 – 8428. Available at http://www.jurnal.unsyiah.ac.id/kanun/article/view/7061/6825; MARBOE, Irmgard. *Calculation of compensation and damages in international investment law*. 2nd ed. Oxford : Oxford University Press, 2012. P. 20, paras 2.45-2.46.

[12] DUGAN, Christopher F., WALLACE, Don, RUBINS, Noah and ṢABĀḤĪ, Burzū. *Investor-state arbitration*. New York : Oxford University Press, 2011. P. 438.

[13] DERAINS, Yves and SICARD-MIRABAL, Josefa. Chapter 5: Expropriation. In: *Introduction to Investor-State Arbitration*. Alphen aan den Rijn : Wolters Kluwer, 2018, pp. 115 – 132. P. 117.

[14] Expropriation - A Sequel. United Nations Conference on Trade and Development (UNCTAD) Series on Issues in International Investment Agreements II. *UN instance* [online]. 21 February 2013, p. 5 [Accessed 20 June 2019]. Available at https://www.un-ilibrary.org/united-nations/expropriation-a-sequel_098cf83b-en. (hereinafter as UNCTAD II)

The takings may occur in the form of an open and deliberate seizure of a property with a simultaneous transfer of title to property to the host state itself or a state-owned third party.[15] However, some measures short of physical takings can also fall under the term "expropriation" if they permanently destroy the economic value of the investment or deprive the owner of its ability to manage, use or control his or her property in a meaningful way.[16]

In practice, as was described for example in *Santa Elena*, the takings of the property can occur in different forms depriving the foreign investors of their proprietary rights to a different extent.[17] As will be addressed further in detail, emerging from the previous development (especially concerning the measures short of physical takings), the boundaries of the scope of what exactly constitutes the act of taking have got blurred.[18] Hence, it is currently impractical to draw a clear picture of what activities or measures precisely would constitute expropriation.

1.1 Types of expropriation

In reaction to the uncertainty in the practical point of view, certain groups or types of expropriation have crystalized in the theory and ISDS practice.

Although some of the scholars and other professionals have already expressed certain scepticism regarding the need for such division of the concept of expropriation, it seems to be rather commonly accepted that there are different types of takings which require a diverse approach.[19] Nevertheless, it is important to emphasize that no matter what type of expropriation

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[15] NEWCOMBE, Andrew and PARADELL, Lluis. Chapter 7 – Expropriation. In: *Law and practice of investment treaties: Standards of treatment.* Alphen aan den Rijn : Kulwer Law International, 2009. P. 323.

[16] UNCTAD II, p. xi.

[17] *Compañia del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award, 17 February 2000, para. 76;

"*As is well known, there is a* ***wide spectrum of measures that a state may take in asserting control over property, extending from limited regulation of its use to a complete and formal deprivation of the owner's legal title****. Likewise,* ***the period of time involved in the process may vary****—from an immediate and comprehensive taking to one that only gradually and by small steps reaches a condition in which it can be said that the owner has truly lost all the attributes of ownership".*

[18] SORNARAJAH, Muthucumaraswamy. *The International Law on Foreign Investment*. 3rd ed. New York : Cambridge University Press, 2010. P. 363.

[19] STERN, Brigitte. In Search Of The Frontiers Of Indirect Expropriation. In: ROVINE, Arthur, W. *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers.* Volume 1, 2007. [online]. Martinus Nijhoff Publishers, 2008, s. 29-52 [Accessed 26 November 23019]. Available at: http://booksandjournals.brillonline.com/content/books/10.1163/ej.9789004167384.i-336.23. P. 35.

occurs or is found, the rule of thumb is that due and timely compensation has to be paid to the aggrieved investor.[20]

Generally, the three types of taking recognized within the treaty practice and theory are (i) direct, (ii) indirect, and (iii) „tantamount to" or „equivalent to" a taking.[21] The tribunals, however, often only refer to direct and indirect expropriation classifying the last mentioned as an indirect expropriation.[22] In fact, the idea of the third category of takings (apart from direct and indirect) was refused by the tribunal in *S.D. Myers* case.[23] Following the argumentation in *S.D. Myers*, this thesis will also address only direct and indirect expropriation dealing with the measures tantamount to or equivalent to a taking under the discussion regarding indirect expropriation.

1.2 Distinction between direct and indirect expropriation

Cases of certain takings falling under the group of direct expropriation are usually deemed clear and imminent; the other measures, however, are less evident as they are achieved by depriving the investor of rights which results in the investor's loss of control, use, enjoyment or value of their property.[24] The letter refers to the cases of indirect expropriation.

BEEN, Vicki and BEAUVAIS, Joel C. The Global Fifth Amendment? NAFTAs Investment Protections and the Misguided Quest for an International Regulatory Takings Doctrine. SSRN Electronic Journal. 1 April 2002. Vol. 78:30. P. 51

[20] MARBOE, Irmgard. *Calculation of compensation and damages in international investment law*. 2nd ed. Oxford : Oxford University Press, 2012. P.43, para. 3.05.

[21] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P. 22.

[22] *S.D. Myers, Inc. v. Canada*, UNCITRAL, Partial Award, 13 November 2000, para. 286, *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 96.

[23] *S.D. Myers, Inc. v. Canada*, UNCITRAL, Partial Award, 13 November 2000, para. 286;

„*The Tribunal agrees with the conclusion in the Interim Award of the Pope & Talbot Arbitral Tribunal that* ***something that is "equivalent" to something else cannot logically encompass more***. *In common with the Pope & Talbot Tribunal, this Tribunal considers that the drafters of the NAFTA intended the word "tantamount" to embrace the concept of so-called "creeping expropriation"*[usually classified as indirect expropriation]*, rather than to expand the internationally accepted scope of the term expropriation*."

[24] DERAINS, Yves and SICARD-MIRABAL, Josefa. Chapter 5: Expropriation. In: *Introduction to Investor-State Arbitration*. Alphen aan den Rijn : Wolters Kluwer, 2018, pp. 115 – 132. P. 117.

Direct expropriation can be described as the outright physical seizure of a foreign investor's property, or title to such property, by the host state[25] accompanied by a transfer of an essential part of property rights to a different beneficiary.[26] Furthermore, the host state's intent to expropriate is also requisite.[27] For instance, according to UNCTAD in cases of direct expropriation,

> "*there is an **open, deliberate and unequivocal intent**, as reflected in a formal law or decree or physical act, to **deprive the owner of his or her property** through the transfer of title or outright seizure*".[28]

In practice, for illustration, in *Funnekotter* case the tribunal held that Zimbabwe expropriated the claimants' investment by means of a government land acquisition programme and actual physical invasions.[29]

Cases of direct expropriation also appeared in two considerably recent disputes. Firstly, in *Stati*, a case concerning the oil and gas industry, the tribunal found that certain activities of the Kazakh government led to the direct seizure of claimants' rights under the Subsoil Use Contracts.[30] Secondly, in *Flughafen Zürich,* the tribunal held Venezuela responsible for direct

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[25] BLACKABY, Nigel, PARTASIDES, Constantine, REDFERN, Alan and HUNTER, Martin. *Redfern and Hunter on international arbitration*. 6th ed. Oxford, United Kingdom : Oxford University Press, 2015. P. 471.

[26] *Sempra Energy International v The Argentine Republic*, ICSID Case No. ARB/02/16, Award, 28 September 2007, para. 280.

*"The Tribunal **does not in fact believe that there can be a direct form of expropriation if** at least some essential component of the **property right has not been transferred to a different beneficiary**, in particular the State".*

[27] *Ibid.,* para. 282;

"*It is at this point that the **intention to expropriate becomes relevant**, and the parties have discussed this matter with clear attention. The Tribunal is persuaded that while many damages can be inflicted unintentionally, and as such will be entitled to compensation if liability is found to exist, **a transfer of property and ownership requires positive intent***".

[28] UNCTAD II, p 7.

[29] BLACKABY, Nigel, PARTASIDES, Constantine, REDFERN, Alan and HUNTER, Martin. *Redfern and Hunter on international arbitration*. 6th ed. Oxford, United Kingdom : Oxford University Press, 2015. P. 471.

[30] *Anatolie Stati, Gabriel Stati, Ascom Group SA and Terra Raf Trans Traiding Ltd v. Kazakhstan*, SCC Case No. V 116/2010, Award, 19 December 2013, para. 1129 ;

*"Indeed, such an outright seizure of physical assets, contractual rights, and legal title are textbook examples of "direct" expropriation. Hence, **it is indisputable that Kazakhstan directly expropriated Claimants' investments** under Art. 13 ECT and international law in July 2010.".*

expropriation of the General Santiago Mariño international airport which arose upon enactment of the Decree 806.[31]

Whereas the cases of direct expropriation are rather straightforward, the same does not apply to the measures falling within indirect expropriation. The main issue is that indirect expropriation usually neither involves an outright seizure and a transfer of title to the property, nor it evinces clear signs of the state's intent to expropriate.[32]

The cases of an outright seizure of investors' property were, in the first place, the core reason for the protection against expropriatory measures of the host states in international investment law.[33] Direct expropriation, however, has now mostly faded and has been replaced by indirect expropriation and seemingly non-expropriatory activities of states.[34] Indeed, currently, the vast majority of the disputes between states and foreign investors revolves around the measures that do not exactly amount to a direct taking of an investor's property but is detrimental to the existence of his or her investment.[35]

1.3 Expropriation in IIAs

Following the aforementioned, states indeed have certain right to take over the property at their territory, yet this right inevitably meets its limits at the second end of this spectrum in a form of investors' right to property.

The protection of foreign investors from expropriatory measures that do not fulfil legal requirements "*traditionally has been one of the main guarantees found in IIAs*".[36] In order to assure investors that their property will not be arbitrarily seized by the host state's government,

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[31] *Flughafen Zürich A.G. and Gestión e Ingeniería IDC S.A. v. Venezuela*, ICSID Case No. ARB/10/19, Award, 18 November 2014, paras. 494–509.

[32] For further discussion on the issues related to indirect expropriation, see the Part "Indirect Expropriation".

[33] BROWN, Chester. *Commentaries on selected model investment treaties.* Oxford : Oxford University Press, 2013. P. 5.

[34] ALBERTO, Enrique. The Concept of "Indirect Expropriation", its appearance in the international system and its effects in the regulatory activity of governments. *Civilizar Ciencias Sociales y Humanas* [online]. 2011, vol. 11, n. 21, pp. 77-98 [Accessed 20 June 2019]. Available at http://www.scielo.org.co/scielo.php?script=sci_arttext&pid=S1657-89532011000200006&lng=en&nrm=iso.

[35] UNCTAD II, p.15; *Advanced Search | Investment Dispute Settlement Navigator | UNCTAD Investment Policy Hub* [online]. [Accessed 20 June 2019]. Available at https://investmentpolicy.unctad.org/investment-dispute-settlement/advanced-search.

[36] UNCTAD II, p. xi.

states generally include provisions regulating expropriation in their bilateral and multilateral investment treaties, i.e. IIAs.[37] Some states, such as Peru or Ecuador, even included provisions in their constitutions preventing them from adopting changes to the contracts with foreign investors unilaterally.[38]

The development of international protection of foreign investors led the treaty practice regarding expropriation to establish four general requirements for the taking of property to be lawful.[39] Those requirements are (i) a legitimate public purpose; (ii) a non-discriminatory manner of measures in question; (iii) carried out in compliance with the due process; and (iv) for payment of compensation.

Despite the lack of uniformity regarding the wording of provisions regulating expropriation and the differences among miscellaneous IIAs concerning the use of terms, those four requirements remain at the core of a general rule under which expropriatory measures are deemed lawful and thus allowed.[40]

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[37] DERAINS, Yves and SICARD-MIRABAL, Josefa. Chapter 5: Expropriation. In: *Introduction to Investor-State Arbitration*. Alphen aan den Rijn : Wolters Kluwer, 2018, pp. 115 – 132. P. 117.

[38] ŠTURMA, Pavel and Vladimír BALAŠ. *Mezinárodní ekonomické právo*. 2nd ed. Prague : C.H. Beck, 2013. Beckova edice právo. ISBN 978-80-7179-069-3. P. 403.

[39] See, for example, NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 369.

[40] For the sake of illustration of similarities in IIAs practice regarding the wording of expropriation clauses, see, for example:

Germany-Pakistan BIT (1959)

"*Art 3 (2) Nationals or companies of either Party **shall not be subjected to expropriation** of their investments in the territory of the other Party **except for public benefit against compensation**, which shall represent the equivalent of the investments affected. Such compensation shall be actually realizable and freely transferable in the currency of the other Party without undue delay. Adequate provision shall be made at or prior to the time of expropriation for the determination and the grant of such compensation. The legality of any such expropriation and the amount of compensation shall be **subject to review by due process of law***.";

Australia-Indonesia CEPA (2019) "*Article 14.11: Expropriation and Compensation (1.) A **Party shall not expropriate** or nationalise a covered investment either directly or through measures equivalent to expropriation or nationalisation (expropriation), **except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate and effective compensation; and (d) in accordance with due process of law***.";

EU-Singapore FTA (2018)

"*Article 2.6 (1) of Neither Party shall **directly or indirectly nationalise, expropriate** or subject to measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as "expropriation") the covered investments of covered investors of the other Party **except: (a) for a public purpose; (b) in accordance with due process of law; (c) on a non-discriminatory basis; and (d) against payment of prompt, adequate and effective compensation***."

Further arrangements included in the "expropriation" clauses are typical for more recent IIAs. Generally, the more recent IIA is, the more complex structure and wording of the "expropriation" clause (including the respective annexes and protocols) it has.

Thus, especially IIAs concluded in the past two decades usually also address a method of determining the compensation. Frequently, such IIAs require that the compensation amount *"to the fair market value of the covered investment"* or "*the real value of the expropriated investment immediately before the expropriation*" including *"interest at a reasonable rate established on a commercial basis, from the date of expropriation until the date of payment*".[41] Moreover, such compensation shall be "*effectively realisable, freely transferable […] and made without delay*". [42] Which is simply a more detailed specification of a general requirement for compensation to be prompt, adequate, and effective in accordance with the so-called Hull formula mentioned before.[43]

Additionally, the recent IIAs also frequently incorporate the right of an investor affected by expropriatory measures to "*have a prompt review of its claim and of the valuation of its investment, by a judicial or other independent authority of that Party*".[44]

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[41] See, for example, EU – Viet Nam Investment Protection Agreement (2019), Article 2.7; Australia – Hong Kong Investment Agreement (2019), Article 10; Nicaragua – Russian Federation BIT (2012), Article 4; Australia – Lao People's Democratic Republic BIT (1994), Article 7.

[42] Ibid.

[43] For the Hull formula see MARBOE, Irmgard. *Calculation of compensation and damages in international investment law*. 2nd ed. Oxf ord : Oxford University Press, 2012. P.20, paras 2.45-2.46.

[44] See, for example, EU – Viet Nam Investment Protection Agreement (2019), Article 2.7; Finland - Guatemala BIT (2005), Article 5; Ghana – Serbia BIT (2000), Article 7; Czech Republic – Jordan BIT (1997), Article 5.

INDIRECT EXPROPRIATION

Upon a brief characterization of the most important aspects of expropriation in international investment law, it is now time to fully delve into the core of the research questions set at the beginning of this thesis.

In a nutshell, as was indicated before indirect expropriation usually takes place when the host state adopts measures the effect of which is so detrimental that the foreign investor cannot enjoy, use or otherwise profit from his or her investment anymore.[45] The term "measure" here encompasses essentially any action in the form of a regulation, legislation, administrative action or judicial decision undertaken by a host state through its legislative, executive or judicial branches.[46]

Strictly speaking, in cases where an investment tribunal finds a measure to be expropriatory the state is then obliged to compensate the investor in question for losses it had suffered.[47] The rule is the same as in cases of direct seizure of property.

The problem, however, stays with how to identify an expropriatory measure in the first place. As the case may be, the measures adopted are not always that detrimental for the investment or they might be adopted through a long period of time amounting to expropriation only in an aggregate. Moreover, sometimes the measures are simply necessary to adopt in order to preserve the public health, environment or any other society-wide objective; in which case it would seem against the common sense to "penalize" the host state.

Hence, given the abundance of issues related to the matter, not only is the doctrine fairly nonuniform, but also the jurisprudence concerning indirect expropriation is inconsistent, and the results might often be unpredictable.[48]

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[45] BISHOP, R. Doak, James CRAWFORD and W. Michael REISMAN. *Foreign investment disputes: cases, materials, and commentary*. 2nd ed. Alphen aan den Rijn : Kluwer Law International, 2014. P. 745.

[46] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P. 8.

[47] MARBOE, Irmgard. *Calculation of compensation and damages in international investment law*. 2nd ed. Oxford : Oxford University Press, 2012. P.20, paras 3.05 *et seq*.

[48] DOLZER, Rudolf. Indirect expropriations: new developments. *New York University Environmental Law Journal*. 2002, 11(1), 64-93. P. 68.

1. DEVELOPMENT OF THE CONCEPT OF INDIRECT EXPROPRIATION

The need to protect foreign investors against potentially arbitrary conduct of the host-state, has been recognized for a long time in international public law.[49] Consequently, examining the state's measures aggravating investor's activity led to the establishment of a concept of indirect expropriation. It is reflected in many scholarly works, modern treaty practice and especially it has been a subject to different claims brought before international investment tribunals.[50]

Prior to the complex provisions formed within the practice of IIAs, several international legal instruments have mentioned indirect expropriation and attempted codify the attributes of measures amounting thereto.[51]

One of the earliest references can be found in the 1959 *Abs-Shawcross Draft Convention* which stated that "*[n]o Party shall [**deprive a national] directly or indirectly** of their property […].*"[52]

Similarly, the 1961 *Harvard Draft Convention* contained that

"*[a] "taking of property" includes **not only an outright taking of property** but also **any such unreasonable interference with the use, enjoyment, or disposal of property** as to justify an inference that the **owner thereof will not be able to use, enjoy, or dispose of the property** within a reasonable period of time after the inception of such interference."*

and

"[…] any unreasonable interference with the use or enjoyment of property for a limited period of time."[53]

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[49] BURGHETTO, María, Beatriz and LORFING, Pascale, Accaoui, The Evolution and Current Status of the Concept of Indirect Expropriation in Investment Arbitration and Investment Treaties. *Indian Journal of Arbitration Law*. 2017, VI (2), pp. 98 -123. P.100; See also Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104 (1978), Decision, 26 June 1978, p. 99.

[50] SCHREUER, Christoph. The Concept of Expropriation under the ETC and other Investment Protection Treaties. Transnational Dispute Management (TDM) [online]. 1 June 2005, 2.3. [Accessed 20 June 2019]. Available at https://www.transnational-dispute-management.com/article.asp?key=467. P. 1, para. 1.

[51] DOLZER, Rudolf and BLOCH, Felix. Indirect Expropriation: Conceptual Realignments? *International Law FORUM du droit international*. 2003, 5(3), pp. 155–165. P. 156.

[52] "*The Draft Convention on Investments Abroad (Abs-Shawcross Draft Convention)*", In: Herman ABS, and SHAWCROSS, Hartley. Draft Convention on Investments Abroad. In: The proposed convention to protect private foreign investment: a round table. *Journal of Public Law (presently Emory Law Journal)*, 1960, 1, pp. 115-118. Article III.

[53] "*Harvard draft convention on the International Responsibility of States for Injuries to Aliens", In:* SOHN, Louis B. and BAXTER, R. R. Responsibility of States for Injuries to the Economic Interests of Aliens: II. Draft

The 1980 *Restatement (Third) of the Foreign Relations Law of the United States* also stated that it applied "*to not only avowed expropriation in which the government formally takes title to property, but also to* ***other actions of the government that have the effect of "taking" the property****, […]*".[54]

The 1967 *OECD Draft Convention* also recognized indirect expropriation by establishing that "*no Party shall take any measures* ***depriving, directly or indirectly****, [a national] of his property […]".*[55] Additionally, according to the commentary thereof, measures amounting to indirect expropriation would be those that:

"*[aimed] to* ***deprive ultimately the alien of the enjoyment or value of his property, without any specific act being identifiable as outright deprivation****. As instances may be quoted excessive or arbitrary taxation; […] refusal of access to raw materials or of essential export or import licences."*[56]

The three latter mentioned, were frequently referred to by the investment tribunals when assessing cases of indirect expropriation becoming a stable referential legal body even though the *OECD Draft Convention* and the *Harvard Draft Convention* were never adopted.[57]

Finally, the OECD's multilateral agreement on investment (MAI) provided that "*a* ***Contracting Party shall not expropriate or nationalise directly or indirectly*** *an investment in its territory of an investor of another Contracting Party* ***or take any measure or measures having equivalent effect****.*" [58]

Convention on the International Responsibility of States for Injuries to Aliens. *The American Journal of International Law.* 1961, 55(3), 548. Article 10(3), a) and b).

[54] *Restatement (Third) of the Foreign Relations Law of the United States*, § 712, comment g. In: ANON. Restatement of the Law, Third, Foreign Relations Law of the United States. *The American Law Institute*. Case Citations, Rules and Principles, Part VII, Chapter II - Injury to Nationals of Other States, Restat 3d of the Foreign Relations Law of the U.S., § 712.

[55] "*OECD Draft Convention on the Protection of Foreign Property*. *Article 3".* In: ANON. OECD Draft Convention on the Protection of Foreign Property. *The International Lawyer.* 1968, 2(2), pp. 331-353. American Bar Association. Pp. 337-338. https://www.jstor.org/stable/40704497

[56] *Ibid*.

[57] See, for example, *Saluka, Pope &Talbot* or *Inicia.*

[58] The objective of this treaty was to provide a broad multilateral framework for international investment with high standards for the liberalisation and investment protection. Negotiations were, however, discontinued in 1998.

Multilateral Agreement on Investment. *OECD* [online]. [Accessed 3 December 2019]. Available at: https://www.oecd.org/investment/internationalinvestmentagreements/multilateralagreementoninvestment.htm

Likewise, following the treaty and arbitration practice, also *UNCTAD* provided with the characterization of measures falling under indirect expropriation by assembling certain cumulative elements. Those elements are (a) attributability of the measure adopted to the host state; (b) interference of the measure with the property rights or other protected legal interests; (c) impact of measures imposed is of such degree that the relevant rights or interests lose all or most of their value or the owner is deprived of control over the investment; (d) despite the fact that the owner retains the legal title or remains in physical possession.[59]

Notwithstanding these attempts of codification and description of indirect expropriation concept, there is still no clear definition thereof and is yet to be established.[60]

1.1 Forms of indirect expropriation

On the grounds of disunity and ambiguities in terminology one can also encounter references to de facto, disguised, creeping [61] or consequential[62], constructive, regulatory[63] or

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[59] UNCTAD II,, p. 12.

[60] *Lauder v. Czech Republic*, UNCITRAL, IIC 205 (2001), Final Award, 3 September 2001, para. 200; *Saluka Investments B.V. v The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para. 263.

[61] See, for example, BISHOP, R. Doak, James CRAWFORD and W. Michael REISMAN. *Foreign investment disputes: cases, materials, and commentary*. 2nd ed. Alphen aan den Rijn : Kluwer Law International, 2014. P. 745; RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P. 57; PAPARINSKIS, Martins. Chapter 13: *Regulatory Expropriation and Sustainable Development*. In: SEGGER, Marie-Claire, GEHRING, Markus W. and NEWCOMBE, Andrew. *Sustainable development in world investment law*. Alphen aan den Rijn : Kluwer Law International, 2011, pp. 299 – 327. Pp. 305-306; And, for example, cases *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, Award, ICSID Case No. ARB/05/22, 24 July 2008, para. 408, 415; *LG&E Energy Corp, LG&E Capital Corp and others v The Argentine Republic*, Decision on Liability, ICSID Case No. ARB/02/1, 3 October 2006, para. 188-194; *Generation Ukraine Inc v. Ukraine*, ICSID Case No. ARB/00/9, Award, 16 September 2003, paragraph 20.29, para. 20.22.

[62] See, for example, BISHOP, Doak R., CRAWFORD, J. R. and REISMAN, Michael. *Foreign investment disputes: Cases materials and commentary*. 2nd ed. Alphen aan den Rijn : Kluwer Law International, 2014. P. 1075; REISMAN, W. Michael and SLOANE, Robert D. Indirect Expropriation and Its Valuation in the Bit Generation. *British year book of international law*. 2004, 74(1), 115-150. Pp. 128-133; NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 395.

[63] See, for example, PAULSSON, Jan. Indirect Expropriation: Is the Right to Regulate at risk? *Transnational Dispute Management (TDM)* [online]. 1 April 2006. [Accessed 2 December 2019]. Available at: http://www.transnational-dispute-management.com/article.asp?key=776; NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. Pp. 341 *et seq.*

virtual expropriation.[64] Nevertheless, the aforesaid denominations are deemed to fall under the scope of indirect expropriation as its subcategories.[65]

Miscellaneous forms of indirect expropriation were referred to in scholarly works and international investment arbitration practice. Usually, the tribunals tried to distinguish individual those forms by assessing the time frame and the number of acts and measures adopted by the host state or by examination of the state's regulatory framework.

Some of the types of indirect expropriation acquired intensified attention of scholars and international investment tribunals which tried to describe the essential attributes thereof. Thus, this thesis will further elaborate on the three mostly discussed categories – creeping (or consequential), disguised expropriation and measures tantamount to or equivalent to expropriation.

1.1.1 Creeping and consequential expropriation

The distinctive feature of these types of indirect expropriation is that both in the end lead to deprivation of investor's property but do so gradually. Hence, some of such activities of the host states could be left unnoticed and the investors would not be granted any protection.

Both creeping and consequential expropriations involve the chain of events that rarely reveals any dramatic moment which would demarcate the act of expropriation.[66] Therefore, the assessment of those forms of indirect expropriation is accompanied by several difficulties.

> Firstly, as was concluded in *Generation Ukraine*, "*[a]lthough international precedents on indirect expropriation are plentiful, it is difficult to find many cases that fall squarely into the more specific paradigm of creeping expropriation.*"[67]

Thus, there is not sufficient number of decisions that would provide with clear guidelines on how to assess the potential cases of creeping or consequential expropriation.

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[64] UNCTAD II, p. 26; NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 326.

[65] SUBEDI, P. Surya. *International investment law: reconciling policy and principle*. Oxford : Hart Publishing Ltd., 2016. P. 76-77. MCLACHLAN, Campbell, SHORE, Laurence and WEINIGER, Matthew. International investment arbitration substantive principles. Oxford : Oxford University Press, 2017. P. 383, para. 8.75.

[66] REISMAN, W. Michael; SLOANE, Robert D. Indirect Expropriation and Its Valuation in the Bit Generation. *British year book of international law*. 2004, 74(1), 115-150. P.142.

[67] *Generation Ukraine Inc v. Ukraine*, ICSID Case No. ARB/00/9, Award, 16 September 2003, para. 20.22.

Secondly, under creeping or consequential expropriation the measures or acts of the state are deemed to be wrongful and amounting to expropriation only in aggregate. Thus, in case that the chain of events is scattered in sufficient amount of time, it sure will be very difficult to evaluate the picture as a whole. Not mentioning the difficulties with the evaluation of the prospective compensation.

As was mentioned by *Reisman & Sloane* "*a creeping expropriation is comprised of a number of elements, none of which can – separately – constitute the international wrong*."[68]

According to *prof. George C. Christie*, those types of indirect expropriation

"*often mature into explicit takeovers as events take their course, and in the absence of legal machinery capable of reacting swiftly and efficiently to these situations when they arise, claims relating to them tend to become mooted or, in any event, less demanding of legal attention.*"[69]

Two prominent cases attempted to bring certain specification of creeping expropriation.

Firstly, the tribunal in *Generation Ukraine* concluded that creeping expropriation *"is a form of indirect expropriation with a* ***distinctive temporal quality*** *[…] whereby a* ***series of acts*** *attributable to the State* ***over a period of time culminate in the expropriatory taking*** *of such property*."[70]

Similarly, the tribunal in *Telenor* observed that expropriation does not necessarily have to be caused by a single act but *"there may be "creeping" expropriation involving* ***a series of acts over a period of time none of which is itself of sufficient gravity to constitute an expropriatory act*** *but all of which taken* ***together produce the effects of expropriation***."[71]

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[68] REISMAN, W. Michael; SLOANE, Robert D. Indirect Expropriation and Its Valuation in the Bit Generation. *British year book of international law*. 2004, 74(1), 115-150. P. 123. [*In the original quoting the dissenting opinion of Keith Highet in Waste Management v. Mexico, Award of 2 June 2000 (Exh. CL-177)*]

[69] WESTON, Burns H., "Constructive Takings" Under International Law: A Modest Foray into the Problem of "Creeping Expropriation". *Virginia Journal of International Law*. 1975, 16(1), 103-176. ISSN: 0042-6571. P. 107; See also CHRISTIE, G.C. What constitutes a taking of property under international law? *British Yearbook of International Law*. 1962, 38, 307–338. P. 310.

[70] *Generation Ukraine Inc v. Ukraine*, ICSID Case No. ARB/00/9, Award, 16 September 2003, para. 20.22.

[71] *Telenor Mobile Communications AS v The Republic of Hungary*, Award, ICSID Case No. ARB/04/15, 22 June 2006, para. 63.

The tribunal in *Burlington* also emphasized that a "creeping approach" should be *"employed only when no single measure is in itself expropriatory*."[72]

Lastly, as for a consequential expropriation, according to *Reisman and Sloane* it involves a "*state's interference with or failure to create or maintain the normative legal, administrative, and regulatory framework contemplated by a BIT, as a consequence of which managerial control, profitability, and ultimately viability, erode"*.[73]

1.1.2 Disguised expropriation

The specific feature of disguised expropriation is that it results in a total taking of investor's property which makes it quite shifted towards direct expropriation. The only difference is that in order to expropriate the host state does not use any formal means which its law prescribes.[74]

For instance, disguised expropriation was referred to in *ELSI* case. The United States there charged Italy for a requisition of ELSI, a company the main shareholder of which was a U.S. manufacturer of electronics and for the subsequent purchase of ELSI's assets for a sum well below market value.[75] The ICJ found that Italy's conduct amounted to expropriation and concluded that "*[the measures] alleged by the Applicant, if not an overt expropriation, might be regarded as a* ***disguised expropriation****; because,* ***at the end of the process, it is indeed title to property itself that is at stake***." [76]

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[72] *Burlington Resources, Inc v Republic of Ecuador*, Decision on Liability, ICSID Case No ARB/08/5, 14 December 2012, para 345.

[73] REISMAN, W. Michael; SLOANE, Robert D. Indirect Expropriation and Its Valuation in the Bit Generation. *British year book of international law*. 2004, 74(1), 115-150. P.142.

[74] PAPARINSKIS, Martins. Chapter 13: *Regulatory Expropriation and Sustainable Development*. In: SEGGER, Marie-Claire, GEHRING, Markus W. and NEWCOMBE, Andrew. *Sustainable development in world investment law*. Alphen aan den Rijn : Kluwer Law International, 2011, pp. 299 – 327. Pp. 305-306.

[75] *Latest developments | Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy) | International Court of Justice* [online]. [Accessed 20 November 2019]. Available from: https://www.icj-cij.org/en/case/76.

[76] *Elettronica Sicula SpA (ELSI), United States v Italy*, ICJ GL No 76, CJ Rep 15, (1989) 28 ILM 1109, ICGJ 95 (ICJ 1989), Judgment, Merits, 20th July 1989, United Nations ; International Court of Justice. P. 11.

Simply stating, the disguised expropriation takes place when the title or most powers associated with ownership are transferred.[77]

1.1.3 Measures "tantamount to" or "equivalent to" expropriation

Lastly, the wording "tantamount to" or "equivalent to" expropriation is very commonly used in treaty practice and thus has been addressed by several tribunals in international investment arbitration.

Nevertheless, the tribunals refused to put this wording on a par with the direct and indirect expropriation as the third type of expropriation in general. Otherwise, it would lead to an inadmissible extension of the term expropriation as such.[78]

In *Pope & Talbot* the tribunal expressly refused to

> "*believe that the phrase "measure tantamount to nationalization or expropriation" in Article 1110 [NAFTA] broadens the ordinary concept of expropriation under international law to require compensation for measures affecting property interests without regard to the magnitude or severity of that effect*."[79]

Similarly, the tribunal in *Telenor* held that "*phrases such as "equivalent to expropriation" and "tantamount to expropriation"* ***do not expand the concept of expropriation*** *and are usually taken to indicate that the BIT covers indirect as well as direct expropriation, […] the same is true of "measures having a similar effect"[…]."*[80]

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[77] PAPARINSKIS, Martins. Chapter 13: *Regulatory Expropriation and Sustainable Development*. In: SEGGER, Marie-Claire, GEHRING, Markus W. and NEWCOMBE, Andrew. *Sustainable development in world investment law*. Alphen aan den Rijn : Kluwer Law International, 2011, pp. 299 – 327. Pp. 305-306.

[78] *S.D. Myers, Inc. v. Canada*, UNCITRAL, Partial Award, 13 November 2000, para. 285; MARTÍNEZ-FRAGA, Pedro J. and REETZ, C. Ryan. *Public purpose in international law: rethinking regulatory sovereignty in the global era*. Cambridge : Cambridge university press, 2017. P. 108.

[79] *Pope & Talbot v Canada*, UNCITRAL, Interim Award, 26 June 2000, para 97.

[80] *Telenor Mobile Communications AS v The Republic of Hungary*, Award, ICSID Case No. ARB/04/15, 22 June 2006, para. 63.

1.2 Features of indirect expropriation

Picking up the threads of what was briefly indicated before, contrary to the cases of direct expropriation, establishing indirect expropriation is accompanied by several perplexing issues.

Firstly, in cases of indirect expropriation there is no transfer of title to property even though the foreign investment in question is practically rendered useless due to the host state's activity.[81] Actually, one of the core characteristics of indirect expropriation resides in the fact that there is "*no change effected to the rights of possessions of the physical property of foreign investors*".[82]

According to *Redfern & Hunter* indirect expropriation is caused by a measure that "*does not involve an overt taking, but that effectively neutralizes the enjoyment of the property*".[83] Similarly, *Sicard-Mirabal & Derains* described indirect expropriation as a situation when the investor keeps its property, but the value of the investment is severely affected by measures adopted by the state.[84]

Dr. Kunoy,[85] *prof. Newcombe* and *Dr. Paradell*[86] also unanimously concluded that it is not necessary for indirect expropriation that the formal transfer of title occurs, however, only under the condition that the state's measure causes a substantial deprivation to investor's property rights. The tribunals in *Santa Elena* and *CME* came to the same conclusion.[87]

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[81] See, for example, UNCTAD II, p. 7; NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 323; SCHREUER, Christoph. The Concept of Expropriation under the ETC and other Investment Protection Treaties. *Transnational Dispute Management (TDM)* [online]. 1 June 2005, 2.3. [Accessed 20 June 2019]. Available at https://www.transnational-dispute-management.com/article.asp?key=467. P. 1.

[82] SORNARAJAH, Muthucumaraswamy. *The International Law on Foreign Investment*. 3rd ed. New York : Cambridge University Press, 2010. P. 367.

[83] BLACKABY, Nigel, PARTASIDES, Constantine, REDFERN, Alan and HUNTER, Martin. *Redfern and Hunter on international arbitration*. 6th ed. Oxford, United Kingdom : Oxford University Press, 2015. P.471.

[84] DERAINS, Yves and SICARD-MIRABAL, Josefa. Chapter 5: Expropriation. In: *Introduction to Investor-State Arbitration*. Alphen aan den Rijn : Wolters Kluwer, 2018, pp. 115 – 132. P. 115.

[85] KUNOY, Bjørn. Developments in Indirect Expropriation Case Law in ICSID Transnational Arbitration. *The Journal of World Investment & Trade*. 2005, 6(3), 467–491. P.472.

[86] NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 369.

[87] *Compañia del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award, 17 February 2000, para. 76;

Secondly, cases of indirect taking usually do not evince any visible sign of the state's intent to expropriate which makes it even more difficult to identify.[88]

According to *prof Schreuer* it is a generally accepted assumption that the bad faith (or the host state's intent to expropriate) is not requisite for the purpose of establishing indirect expropriation.[89] Furthermore, as *prof Christie* concluded in his article on takings of property;

> *"[S]tate' s mere declaration that expropriation is not intended is not determinative of the issue. Even when these protestations are made in good faith the cases have shown that* ***expropriation can be an unintended result of a State's action****".*[90]

There were also several cases where tribunals specifically established that the intent to expropriate is not crucial in order to find the state's measures expropriatory.[91] On the other

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"[…] measure or series of measures can still eventually amount to a taking, though the individual steps in the process do not formally purport to amount to a taking or to a transfer of title".

CME Czech Republic B.V. v. Czech Republic, UNCITRAL, Partial Award, 13 September 2001, para. 150;

"Such expropriations may be deemed to have occurred regardless of whether the State "takes" or transfers legal title to the investment".

[88] NEWCOMBE, Andrew and PARADELL, Lluis. NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 342; CHRISTIE, G.C. What constitutes a taking of property under international law? *British Yearbook of International Law*. 1962, 38, 307–338. P. 310: "*There are several well-known international cases in which it has been recognized that property rights may be so interfered with that it may be said that to all intents and purposes those property rights have been expropriated even though* ***the State in question has not purported to expropriate***.".

[89] SCHREUER, Christoph. The Concept of Expropriation under the ETC and other Investment Protection Treaties. *Transnational Dispute Management (TDM)* [online]. 1 June 2005, 2.3. [Accessed 20 June 2019]. Available at https://www.transnational-dispute-management.com/article.asp?key=467. P. 36, para. 108.

[90] CHRISTIE, G.C. What constitutes a taking of property under international law? *British Yearbook of International Law*. 1962, 38, 307–338. P. 337.

[91] See, for example, *Chemtura Corporation v. Government of Canada*, UNCITRAL, Award, 2 August 2010, para. 242:

"*For a measure to constitute expropriation under Article 1110 of NAFT A, it is common ground that (i) bad faith on the part of the Respondent is not required*";

Compañía de Aguas del Aconquija S.A., Vivendi Universal v Republic of Argentina, ICSID Case No. ARB/97/3, Award, 20 August 2007, para. 5.3.24:

"*[…]it is well established that the government's intent to expropriate, or lack thereof, is not a principal concern.*";

Lauder v. Czech Republic, UNCITRAL, IIC 205 (2001), Final Award, 3 September 2001, para. 197;

"*The intent of the State to deprive the investor of property is not a necessary element of expropriation.*".

hand, for instance the tribunal in *Sea-Land Service* required that there was a "*deliberate governmental interference*" on the part of the host state as well as an "*intentional course of conduct directed against Sea-Land*".[92]

Additionally, it was found that in cases where the intent to expropriate can be undoubtedly proven, that shall be taken into consideration as an aggravating circumstance to the disadvantage of the host state.[93] Due to the differences in IIA's wordings, though, several tribunals dismissed the concept of the intent to expropriate on the basis of the lack of foundation therefor in the respective IIA.[94]

The fact that there is an evident sign of the state's benefit from the expropriatory measures was not found to be imperative either. Indeed, the measures amounting to indirect expropriation do not have the same effect as in the cases of direct takings where the seizure of property imposed on a private person corresponds with the acquisition of certain avail by the public person.[95] For instance, in *Metalclad* and *CME* the tribunals held that in the cases of indirect expropriation the host state does not necessarily have to be the beneficiary of the aggrieved investment.[96]

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[92] *Iran-US Claims Tribunal, Sea-Land Services, Inc. v. Iran,* 6 IRAN-U.S. C.T.R., Award, 22 June 1984, para. 50.

"*A finding of expropriation would require, at the very least,* ***that the Tribunal be satisfied that there was deliberate governmental interference with the conduct of Sea-Land's operation, the effect of which was to deprive Sea-Land of the use and benefit of its investment***."

[93] *Anatolie Stati, Gabriel Stati, Ascom Group SA and Terra Raf Trans Traiding Ltd v. Kazakhstan*, SCC Case No. V 116/2010, Award, 19 December 2013, para. 1468;

"*Professors Reisman and Sloane would agree: where the intent to expropriate can be proven, the State's intent to expropriate should be given significant weight in the assessment of the proper valuation date*."

[94] *Siemens A.G. v The Argentine Republic*, Award, ICSID Case No. ARB/02/8, 17 January 2007, para. 270;

"*Argentina has argued against taking into consideration only the effect of measures for purposes of determining whether an expropriation has taken place. The Tribunal recalls that Article 4(2) refers to measures that "a sus efectos" (in its Spanish original) would be equivalent to expropriation or nationalization. The Treaty refers to measures that have the effect of an expropriation; it does not refer to the intent of the State to expropriate.*".

[95] NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 324.

[96] *Metalclad Corporation v The United Mexican States*, ICSID Case No. ARB (AB)/97/1, Award, 30 August 2000, para. 103.

"*Thus, expropriation under NAFTA includes […] also covert or incidental interference with the use of property which has the effect of depriving the owner […] of the use or reasonably-to-be-expected economic benefit of property* ***even if not necessarily to the obvious benefit of the host State.***";

Thirdly, there is no exhaustive list of actionable measures that constitute indirect expropriation; hence, it is always on the tribunals' deliberation whether indirect expropriation occurred. That would not cause a problem *per se*, however, what highly complicates the situation is the lack of a uniform test providing the tribunals with clear limits to their deliberation leading to fairly inconsistent approach to the issue of indirect expropriation.

As a result of the foregoing, the line between indirect expropriation and non-expropriatory regulations which are deemed to not trigger the obligation to compensate is very blurred, or rather, almost non-existent.[97] This can be illustrated for example by the two frequently criticized decisions of the cases *Lauder*[98] and *CME*[99]. Despite having virtually identical[100] factual background the tribunals reached opposite conclusions concerning the Czech Republic's liability for deprivation of the Claimant. Thus, while the tribunal in *Lauder* found that there was no case of expropriation the *CME* tribunal reached the opposite conclusion regarding the same measures.[101]

Nevertheless, at least the requirement of one of the indirect takings' features stands undisputed. The scholars and other professionals have commonly agreed that regardless any other aspects, the state's measures need to have a certain degree of adverse impact on the investment in order to be deemed expropriatory.[102] According to *Reinisch*, usually, a "*minor*

CME Czech Republic B.V. v. Czech Republic, UNCITRAL, Partial Award, 13 September 2001, para. 150;

"*Such expropriations may be deemed to have occurred regardless […]. It is also immaterial whether the State itself (rather than local investors or other third parties) economically benefits from its actions*".

[97] WEINER, Allen. Indirect Expropriations: The Need for a Taxonomy of "Legitimate" Regulatory Purposes. *International Law FORUM du droit international* [online]. 2003, 5(3), pp. 166-175 [Accessed 20 June 2019]. Available at https://brill.com/view/journals/inla/5/3/article-p166_5.xml. P. 167.

[98] *Lauder v. Czech Republic*, UNCITRAL, IIC 205 (2001).

[99] *CME Czech Republic B.V. v. Czech Republic*, UNCITRAL, Partial Award, 13 September 2001.

[100] *CME Czech Republic B.V. v. Czech Republic*, UNCITRAL, Partial Award, 13 September 2001, para. 412.

[101] ANON., 2019. Iisd.org [online] [accessed. 3 . December 2019]. Available at https://www.iisd.org/sites/default/files/publications/int_investment_law_and_sd_key_cases_2010.pdf. P. 33; ANON., 2019. CME v. Czech Republic, Lauder v. Czech Republic – Investment Treaty News. Iisd.org [online] [accessed. 3 . December 2019]. Retrieved z: https://www.iisd.org/itn/2018/10/18/cme-v-czech-republic-lauder-v-czech-republic/.

[102] See, for example, REINISCH, August. *Expropriation.* In: MUCHLINSKI, Peter, ORTINO, Federico, and SCHREUER, Christoph. *The Oxford Handbook of International Investment Law.* 2008. Pp. 438-439; Indirect expropriations: new developments. *New York University Environmental Law Journal*. 2002, 11(1), 64-93. P. 79,

restriction [of] or interference with" the investor's property would not amount to indirect expropriation.[103] Generally, a "*severe economic impact*" or a "*substantial loss of control or value*" has to be found.[104]

Hence, while establishing indirect expropriation the decisive aspect taken into consideration is precisely the gravity of the state's interference with the investor's property. As pointed out by *Dolzer & Brunetti*, it is generally acknowledged that "***the severity of the impact*** *upon the legal status and the factual impact on the ability of an investor to use and enjoy his property* ***always constitutes a cardinal factor in determining*** *whether or not an* ***expropriation*** *can be said to have occurred*."[105]

The problem is, however, that there is little to no agreement on the exact criteria for the assessment of such an impact. Firstly, different amount of strictness is required by sundry scholars and arbitrators. Secondly, there is no agreement regarding whether the impact is on the economic values of the investment or the investors control thereover. Finally, there are also certain disagreements as to the duration of the impact or interference. All of which has been addressed within the ISDS practice.

In the following, this thesis focuses on the most relevant decisions of international investment tribunals which have influenced and formed the approach to the concept of indirect expropriation.

REISMAN, W. Michael; SLOANE, Robert D. Indirect Expropriation and Its Valuation in the Bit Generation. *British year book of international law*. 2004, 74(1), 115-150. P.121.

[103] REINISCH, August. *Expropriation.* In: MUCHLINSKI, Peter, ORTINO, Federico, and SCHREUER, Christoph. *The Oxford Handbook of International Investment Law.* 2008. P. 438.

[104] OECD. "Indirect Expropriation" and the "Right to Regulate" in International Investment Law". *OECD Working Papers on International Investment.* 2004, 2004(04), 22pp. Paris: OECD Publishing. https://doi.org/10.1787/780155872321. P. 10; UNCTAD Taking of Property. United Nations Conference on Trade and Development (UNCTAD) Series on Issues in International Investment Agreements. UN instance [online]. 21 February 2000 [Accessed 20 June 2019]. Available at https://unctad.org/en/Docs/psiteiitd15.en.pdf. P. 41. (hereinafter UNCTAD I)

[105] DOLZER, Rudolf a Felix BLOCH. Indirect Expropriation: Conceptual Realignments? *International Law FORUM du droit international*. 2003, 5(3), pp. 155–165. P. 164.

2. INDIRECT EXPROPRIATION IN ISDS PRACTICE

The issue of takings that are indirect has gradually become one of the most important developments in the decision-making process of international investment tribunals currently causing cardinal difficulties therein.[106]

During the past few decades, the concept of indirect expropriation was being addressed by the tribunals rather extensively leaving us with an impressive body of approximately forty of what can be called "milestone" cases helping to shed some light on the matter.[107]

Without mentioning the cases decided by the international courts and tribunals earlier in the 20th century, the previously mentioned can be very well illustrated by the survey provided by UNCTAD. Since 1994 so far 409 cases based on the alleged indirect expropriation have been brought before international tribunals.[108] Compared to 120 cases based on allegations of direct expropriation[109] it is safe to state that vast majority of investor-state disputes nowadays revolve around the measures that do not involve an overt taking but that effectively neutralize the benefit of the property of the foreign owner.[110] Nevertheless, to stand such a claim is without any doubt rather difficult (out of the 409 cases only 122 cases were held to be founded, and thus decided in favour of investor).[111]

References to indirect expropriation can be found even in some of the older cases. One of such cases is a 1926 PCJ case *German Interests in Polish Upper Silesia*.[112] The conflict arose

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[106] DOLZER, Rudolf a Felix BLOCH. Indirect Expropriation: Conceptual Realignments? *International Law FORUM du droit international*. 2003, 5(3), pp. 155–165. P. 155; DOLZER, Rudolf. Indirect expropriations: new developments. *New York University Environmental Law Journal*. 2002, 11(1), 64-93. P. 65.

[107] *Advanced Search | Investment Dispute Settlement Navigator | UNCTAD Investment Policy Hub* [online]. [Accessed 20 June 2019]. Available at https://investmentpolicy.unctad.org/investment-dispute-settlement/advanced-search.

[108] *Advanced Search | Investment Dispute Settlement Navigator | UNCTAD Investment Policy Hub* [online]. [Accessed 20 June 2019]. Available at https://investmentpolicy.unctad.org/investment-dispute-settlement/advanced-search.

[109] Ibid.

[110] See, for example, *CME Czech Republic B.V. v. Czech Republic*, Partial Award UNCITRAL, 13 September 2001, para. 604.

[111] *Advanced Search | Investment Dispute Settlement Navigator | UNCTAD Investment Policy Hub* [online]. [Accessed 20 June 2019]. Available at https://investmentpolicy.unctad.org/investment-dispute-settlement/advanced-search.

[112] CHRISTIE, C.G. What constitutes a taking of property under international law? *British Yearbook of International Law*. 1962, 38, 307–338. P. 310.; SCHREUER, Christoph. The Concept of Expropriation under the ETC and other Investment Protection Treaties. *Transnational Dispute Management (TDM)* [online]. 1 June 2005,

between Germany and Poland on the grounds of *"the taking over by [Polish Government] of control of the working of the nitrate factory at Chorzow; [and] taking possession of the movable property and patents, licences, etc., of the Bayerische Stickstoffwerke Company"*.[113] The PCJ here concluded that the taking over of the factory by Poland also harmed patents, licences, experiments, etc. of Bayerische which in aggregate was held to amount to indirect expropriation.

Moreover, an impressive amount of cases dealing with the matter of expropriation have been rendered by the Iran-US Tribunal.[114] These cases have also been often relied upon by the investment tribunals when resolving disputes concerning indirect expropriation.[115] Nevertheless, it is important to emphasize that such references to judicial practice of the Iran-US tribunal in investment cases is problematic.[116] Not only the tribunal's procedural rules contain a very wide choice of law clause and the scope of the reviewable measures includes even "*other measures affecting property rights*" but these decisions are also often insufficiently reasoned.[117] However, the interpretative and doctrinal clues given by the Iran- US tribunal in its decisions should not be ignored.

Hence, to mention one of the frequently cited cases, in *Starrett Housing*[118] the tribunal affirmed the conclusion that expropriation does not need to involve an overt taking of property. It encapsulated the concept of indirect takings in a well-known description stating that

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2.3. [Accessed 20 June 2019]. Available at https://www.transnational-dispute-management.com/article.asp?key=467. P. 36, para. 108.

[113] *German Interests in Polish Upper Silesia (Germ. v. Pol.),* 1926 P.C.I.J. (ser. A) No. 7 (May 25), Judgement, 25 August 1925, p. 44.

[114] RAJPUT, Aniruddha. Problems with the Jurisprudence of the Iran–US Claims Tribunal on Indirect Expropriation. *ICSID Review*. 2015, 30(3), pp. 589–615. P.590; for more detail please see HEISKANEN, Veijo. The Doctrine of Indirect Expropriation in Light of the Practice of the Iran-United States Claims Tribunal. *The Journal of World Investment & Trade*. 2007. P. 215–231.

[115] GIBSON, Christopher, and DRAHOZAL, Christopher. *Iran–United States Claims Tribunal Precedent in Investor-State Arbitration. Journal of International Arbitration.* 2006, 23(6), pp.521 *et seq*. P. 540.

[116] See, for example, Pope & Talbot Inc v The Government of Canada, NAFTA, Interim Award, 26 June 2000, para 104.

[117] RAJPUT, Aniruddha. Problems with the Jurisprudence of the Iran–US Claims Tribunal on Indirect Expropriation. *ICSID Review*. 2015, 30(3), pp. 589–615. Pp.590, 600, 607, 611.

[118] Similarly, the tribunal in 1983 case *Tippetts* referring to *prof. Christie* and Lena Goldfield's Case concluded that "*[d]eprivation or taking of property may occur under international law through* ***interference by a state in the use of that property or with the enjoyment of its benefits****, even where legal title to the property is not affected*."

"***measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless*** *that they* ***must be deemed to have been expropriated****, even though […] the legal title to the property formally remains with the original owner*[119]."

Likewise, in *Cement Shipping* indirect expropriation was described as: "*measures […] the* ***effect of which is to deprive the investor of the use and benefit of his investment*** *even though he may retain nominal ownership of the respective rights*".[120]

It follows that in order to depict the concept of indirect expropriation the tribunals generally used its essential attribute which is a host state's adverse interference with the use and the enjoyment of the investor's property. In addition, mostly the recent tribunals started to set a higher liability threshold in indirect expropriation claims adding more aspects to assess before rendering a decision.[121]

Thus, the investment tribunals generally coincidently acknowledged that not only the direct interference with title to property, but also measures detrimental to the enjoyment of investment may constitute expropriation.[122] Nonetheless, the acknowledgement of the existence of indirect expropriation is essentially almost the only point which the tribunals reached an agreement on concerning the matter. The scope of indirect expropriation and approach to the state's measures falling therein is a whole another story.

Many international tribunals have applied a variety of tests in order to assess allegedly expropriatory measures aggravating investor's property; yet no unanimous approach thereto

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Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA, 6 IRAN-U.S. C.T.R., Award, 28 October 1985, para. 219 *et seq*.

[119] *Iran-US Claims Tribunal Starrett Housing Corp. v. Iran*, 16 IRAN-U.S. C.T.R., Interlocutory Award, 19 December 1983, para 66.

[120] *Middle East Cement Shipping and Handling Co. S.A. v Arab Republic of Egypt,* ICSID Case No. ARB/99/6, Award, 12 April 2002, para. 107.

[121] GARCÍA-BOLÍVAR, Omar E. CASE COMMENT Railroad Development Corporation v Republic of Guatemala: The First CAFTA Award on the Merits. *ICSID Review.* 2013, 28(1), pp. 27–32. doi:10.1093/icsidreview/sit010 P. 28.

For more detailed discussion on the sole effects and police powers doctrine, please see the Sections 3.1 and 3.2 in the Part "Right to Regulate and Indirect Expropriation", Chapter 3 of the thesis.

[122] See, for example, *S.D. Myers, Inc. v. Canada*, UNCITRAL, Partial Award, 13 November 2000, para. 281,

"*The Tribunal accepts that, in legal theory, rights other than property rights may be "expropriated" and that international law makes it appropriate for tribunals to examine the purpose and effect of governmental measures*".

has been reached yet.[123] Certain tribunals even expressly mentioned that it is very difficult to find a clear and one-fits-all stance towards the matter due to the diversity of aspects involved in each and every case calling for a well-tailored and facts-specific assessment with few or no generalisations being made.[124]

Indeed, one could argue that certain guidance can be derived from the preceding practice as is often the case for different tribunals do refer to previously resolved investment disputes.[125]

Notwithstanding, there is no such a thing as a doctrine of binding precedent and thus investment tribunals have often reached diverse conclusions based on similar facts and law.[126]

Moreover, one of the elements that is highly affecting international tribunals' decisions are the wordings of respective IIAs. As the tribunals are bound by IIAs under which they hear the case, they simply cannot read more into the wording thereof than there is. Thus, when formulating descriptions of the concept of indirect expropriation the tribunals usually refer specifically to the respective "expropriation clauses" of the IIAs in question.[127]

Thereupon, as was concluded by *SGS* tribunal

"*although different tribunals […] should in general seek to act consistently with each other, in the end it must be for each tribunal to exercise its competence in accordance with*

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[123] DOLZER, Rudolf a Felix BLOCH. Indirect Expropriation: Conceptual Realignments? *International Law FORUM du droit international*. 2003, 5(3), pp. 155–165. p. 155.

[124] See, for example ICSID (para 100); *Saluka Investments B.V. v The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para. 264; LEGUM, Barton. *The investment treaty arbitration review.* London : Law Business Research Ltd, 2017. ISBN 978-1-910813-56-0. P. 177.

[125] As is the case of the ICSID tribunals referring to Iran-US Claims Tribunal's decisions or for example the tribunal in the *Enron & Ponderosa* case, where it referred to the decision of the case Pope & Talbot. The *Enron* tribunal has concluded that "*The **list of measures considered** in the Pope & Talbot case as **tantamount to expropriation**, which the Respondent has invoked among other authorities, is in the Tribunal's view representative of the **legal standard required to make a finding of indirect expropriation***."

Enron Corporation, Ponderosa Assets LP v. The Argentine Republic, ICSID Case No. ARB/01/3, Award, 22 May 2007, paragraph 245.

[126] BLACKABY, Nigel, PARTASIDES, Constantine, REDFERN, Alan and HUNTER, Martin. *Redfern and Hunter on international arbitration*. 6th ed. Oxford, United Kingdom : Oxford University Press, 2015. P. 25 at 1-49.

[127] For example, in a well-known NAFTA case *Metalclad* the tribunal observed that "***expropriation under NAFTA** includes […] also covert or incidental interference with the use of property which has the effect of depriving the owner […]*."

Metalclad Corporation v The United Mexican States, ICSID Case No. ARB (AB)/97/1, Award, 30 August 2000, para. 103.

the applicable law, which will by definition be different for each BIT and each Respondent State. Moreover, there is no doctrine of precedent in international law, if by precedent is meant a rule of the binding effect of a single decision. There is no hierarchy of international tribunals, and even if there were, there is no good reason for allowing the first tribunal in time to resolve issues for all later tribunals."[128]

2.1 Establishing indirect expropriation - essential elements

Although different investment tribunals have brought many general descriptions of indirect expropriation there is still little agreement about the essential elements thereof.[129]

As stems, however, from different decisions where the tribunals dealt with indirect expropriation, the matter intrinsically boils down to three fundamental factors. When establishing indirect expropriation, the tribunals usually assess the impact the state's measures have on the investment, the duration of such measure, and interference with legitimate expectations of the investor in question.[130]

Furthermore, depending on the test the investment tribunal decides to follow (whether police powers or sole effects doctrine) it will also have to include certain deliberation on the nature and purpose of the measures under the scrutiny.

2.1.1 Impact of the measure on the investment

First and foremost, certain impact inflicted by the activity of a state on the investment is a crucial aspect which must be found when establishing the case of indirect expropriation.[131] As the tribunal in *Tecmed* put it "[*i*]*n determining whether a taking constitutes an "indirect*

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[128] SGS Société Générale de Surveillance S.A. v. Republic of the Philippines, Decision of the Tribunal on Objections to Jurisdiction, ICSID Case No. ARB/02/06, 29 January 2004, para 97.

[129] MEG, Kinnear N., BJORKLUND, Andrea K., and HANNAFORD, John F. G. *Investment disputes under NAFTA: An Annotated Guide To NAFTA.* 2006 Alphen aan den Rijn, The Netherlands: Kluwer Law International. P. 1110-15;

[130] UNCTAD II, p. 57.

[131] For more discussion please see the Section 1.2 in the Part "Indirect Expropriation", Chapter 1.

expropriation", it is ***particularly important to examine the effect*** *that such taking may have had* ***on the investor's rights***".[132]

The investment tribunals have commonly agreed that when observing the state's measures through the prism of indirect expropriation it is necessary to look for at least some degree of detrimental interference with the investment in question.[133] Nevertheless, the magnitude of such interference has been approached with different amount of strictness.[134]

In any case, it is without any doubt that the tribunal will not be satisfied with just any interference with the investment in question. For example, in the *LG&E* case it was held that "*in many arbitral decisions, compensation has been denied when it [the State's measure] has not affected all or almost all the investment's economic value*".[135]

One of the most stringent requirements on the degree of impact appeared in *Mamidoil* where "*the* ***decisive criterion*** *for most tribunals is not the fact of having incurred a damage and/or the loss of value as such, but the finding "that the owner* ***has truly lost all the attributes of ownership***".[136] Similarly, in the *Lauder* case, the tribunal stated that the effect of taking must be "***effectively neutralis[ing] the enjoyment*** *of property'*."[137] Additionally, the tribunal in

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[132] *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 115.

[133] See, for example, *UAB E Energija (Lithuania) v. Republic of Latvia*, ICSID Case No. ARB/12/33, Award, 22 December 2017, paragraph 1074.

The tribunal in the case at hand observed that *"indirect expropriation requires a certain degree of interference with the investment on the part of the State"*. Adding that *"in order to amount to expropriation, such interference has to be unreasonable, to cause the investment to be neutralized or useless and to cause the investor to be practically deprived, in whole or in significant part, of the use and enjoyment of its investment.";*

Saluka Investments B.V. v The Czech Republic, UNCITRAL, Partial Award, 17 March 2006, para. 277; "*deprivation of sufficient magnitude to form the basis of an expropriation claim*"

[134] REINISCH, August. *Expropriation.* In: MUCHLINSKI, Peter, ORTINO, Federico, and SCHREUER, Christoph. *The Oxford Handbook of International Investment Law.* 2008. P. 439.

[135] *LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc .v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, para. 191.

[136] *Mamidoil Jetoil Greek Petroleum Products Societe Anonyme SA v. Republic of Albania,* ICSID Case No. ARB/11/24, Award, 30 March 2015, paragraph 566.

[137] SORNARAJAH, Muthucumaraswamy. *The International Law on Foreign Investment*. 3rd ed. New York : Cambridge University Press, 2010. P. 368.

Sempra required that the value of the business had to be "*virtually annihilated*" in order to be deemed expropriated.[138]

Another approach which is very close to the foregoing is the requirement of a "*total or near total deprivation*".[139] In *Venezuela Holdings* where the investor asserted that the new tax regime aggravated its investment which amounted to expropriation, the tribunal dismissed such a claim and held that "*a deprivation requires either a* ***total loss of the investment's value*** *or a* ***total loss of control*** *by the investor of its investment, both of a permanent nature*." [140]

Very common is also a "*substantial deprivation*" test of the investment or its economic benefits which appeared for instance in the *AWG* case.[141]

It appears that the least strict and more ambiguous requirement was put forth by the Pope & Talbot tribunal which concluded that "*the interference must be sufficiently restrictive to support a conclusion that the property has been taken from the owner*."[142]

Consequently, the effect imposed by the measure must be understood as follows: "*the affected property must be impaired to such an extent that it must be seen as "taken"*."[143]

As the degree of interference with the investment has been discussed it is also requisite to elaborate more on the precise elements of the investor's activity which has to be substantially affected in order for indirect expropriation to be held.

In principle, the requirement revolves around three alternative aspects that have to be affected in order for the investment to be deemed taken: "*the effective loss of management, use*

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[138] *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Award, 28 September 2007, para. 285.

[139]REINISCH, August. *Expropriation.* In: MUCHLINSKI, Peter, ORTINO, Federico, and SCHREUER, Christoph. *The Oxford Handbook of International Investment Law.* 2008. Pp. 421-423; SCHREUER, Christoph. The Concept of Expropriation under the ETC and other Investment Protection Treaties. Transnational Dispute Management (TDM) [online]. 1 June 2005, 2.3. [Accessed 20 June 2019]. Available at https://www.transnational-dispute-management.com/article.asp?key=467. P. 31, para. 88; RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P. 24.

[140] *Venezuela Holdings BV et al v. The Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27, Award, 9 October 2014, paras. 286-287.

[141] *AWG Group Ltd. v. The Argentine Republic*, UNCITRAL, Decision on Liability, 30 July 2010, para. 134.

[142] *Pope & Talbot v Canada*, UNCITRAL, Interim Award, 26 June 2000, para. 102.

[143] *Gami Investments, Inc. v. The Government of the United Mexican States*, UNCITRAL, Final Award, 15 November 2004, para. 126.

or control, or a significant depreciation of the value, of the assets of the foreign investor[144]." However, not all the tribunals have agreed whether a sufficient interference with any of these aspects individually would constitute expropriation.

Hence, for example the *Novenergia II* tribunal held that although the state's measures had an impact on the investment, "*they have nevertheless left* ***unaffected the claimant's proprietary rights****"*.[145] Similarly, the Iran-US Claims Tribunal in *Phillips Petroleum observed that*

> "***assumption of control over property by a government does not automatically*** *and immediately* ***justify a conclusion that the property has been taken*** *by the government, thus requiring compensation under international law, such a conclusion is warranted whenever events* ***demonstrate that the owner was deprived of fundamental rights of ownership*** *and it appears that this deprivation is not merely ephemeral*."[146]

Contrarily, several cases revolved around the claims brought by investors not because the state's measures caused a decrease in value of investment, but because it led to a loss of control, which prevented the investor from using or disposing of its investment.[147] Hence in the *Sempra* case, for instance, the tribunal held that "*a finding of indirect expropriation would require … that the investor* ***no longer be in control of its business operation*** *[…]*."[148]

Additionally, in the ADM case tribunal deciding under NAFTA dismissed the claim based on the loss of profit stating that "*the test for expropriation […]* ***cannot be considered in the***

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[144] UNCTAD I, p. 2.

For example, the Enron case tribunal (which referred to decision in the Pope & Talbot case) took into consideration all these aspects jointly when finding substantial deprivation in "*depriving the investor of the control of the investment, managing the day-to-day operations of the company, arrest and detention of company officials or employees, supervision of the work of officials, interfering in the administration, impeding the distribution of dividends, interfering in the appointment of officials and managers, or depriving the company of its property or control in total or in part*".

Enron Corporation, Ponderosa Assets LP v. The Argentine Republic, ICSID Case No. ARB/01/3, Award, 22 May 2007, para. 245.

[145] *Novenergia II - Energy & Environment (SCA) (Grand Duchy of Luxembourg), SICAR v. Kingdom of Spain*, SCC Arbitration (2015/063), Award, 15 February 2018, paragraph 761, page 173.

[146] *Iran-US Claims Tribunal, Phillips Petroleum Co. Iran v. Iran et al*., 21 IRAN-U.S. C.T.R., Award, 29 June 1989, para 97.

[147] UNCTAD II, p. 67.

[148] *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Award, 28 September 2007, para. 285.

abstract or based exclusively on the Claimants' loss of profits*, which is not necessarily a sufficient sole criterion for an expropriation*. [149]

Equally, in the *Biwater* case the tribunal held that *"the fact that the effect of conduct must be considered in deciding whether an indirect expropriation has occurred, does not necessarily import an economic test*."[150]

Finally, it is contentious whether an effective deprivation alone would automatically constitute indirect expropriation. Mostly it would depend on the test the respective tribunal would choose to assess the factual background of the case.[151]

2.1.2 Duration of the interference

Second criterion frequently observed in arbitral practice is the timeframe of measures imposed on the investor in question. A rule of thumb is simple, the requirement often expressed is the one of "permanency".

This classical requirement of permanence appeared in *Tecmed* where it was held that "*it is understood that the measures adopted by a State, whether regulatory or not, are an indirect de facto expropriation if they are* ***irreversible and permanent*** *...*"; further the tribunal has clarified that such deprivation shall not be temporary.[152]

Followingly, according to *Dr. Kunoy* in order to be deemed expropriatory the deprivation should not be merely ephemeral.[153] Additionally, the Iran-US Claims Tribunal in *Tippets* case resorted to the same wording. At first, the tribunal acknowledged that the appointment of a temporary manager by the government could not itself be considered an act depriving property.[154] As a matter of fact, it was the consequent absence of new developments in the

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[149] *ADM v. Mexico*, ICSID CASE No. ARB(AF)/04/05, 21 November 2007, para. 248.

[150] *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, Award, ICSID Case No. ARB/05/22, 24 July 2008, para. 464.

[151] For further discussion see the Part "Right to Regulate and Indirect Expropriation" in this thesis.

[152] *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 116.

[153] KUNOY, Bjørn. Developments in Indirect Expropriation Case Law in ICSID Transnational Arbitration. *The Journal of World Investment & Trade*. 2005, 6(3), 467–491. P.345.

[154] Iran-US Claims Tribunal Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA, 6 IRAN-U.S. C.T.R., Award, 28 October 1985. Para 23.

cooperation and lack of communication on the part of the government that was held expropriatory.[155] Hence the tribunal held that the "*owner was deprived of fundamental rights of ownership and it appears that this deprivation is* ***not merely ephemeral***."[156]

In the case *Biwater* the tribunal held that the requirement regarding the duration of interference with investment shall be for "*at least a meaningful period of time.*"[157]

However, even though the *S.D. Myers* tribunal agreed with the aforementioned, it has also adopted a slightly less strict approach:

> "[*a*]*n expropriation usually amounts to a* ***lasting removal*** *of the ability of an owner to make use of its economic rights although it may be that, in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation,* ***even if it were partial or temporary***."[158]

Contrarily, for example in *Cement Shipping* case the tribunal was satisfied with a temporary 4 months period deprivation of the investor's rights it had been granted.[159]

Therefore, it seems that the precise requirement as regards the duration of an interference with investment is of non-evanescence or non-ephemerality.

2.1.3 Expectations of the investor

Some of the tribunals also took into consideration legitimate expectations of the investors in question as one of the important aspects of property protection.[160]

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[155] Ibid.

[156] *Iran-US Claims Tribunal Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA*, 6 IRAN-U.S. C.T.R., Award, 28 October 1985. Para 22.

[157] *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, Award, ICSID Case No. ARB/05/22, 24 July 2008, para. 463.

[158] *S.D. Myers, Inc. v. Canada*, UNCITRAL, Partial Award, 13 November 2000, para 283.

[159] *Middle East Cement Shipping and Handling Co. S.A. v Arab Republic of Egypt,* ICSID Case No. ARB/99/6, Award, 12 April 2002, para. 107.

[160] MUCHLINSKI, Peter, ORTINO, Federico, and SCHREUER, Christoph. *The Oxford Handbook of International Investment Law.* 2008. P. 448.

According to *prof. Reinisch* in the ambit on international investment law, "*the disappointment of legitimate investor expectations by host states may play a crucial factor […] also in the determination of whether an expropriation has taken place*."[161]

But, for instance, the tribunal in *EnCana* conditioned the scrutiny of such a requirement by the previous commitments made by the state towards the investor. The tribunal observed that "[***i***]***n the absence of a specific commitment*** *from the host State, the* ***foreign investor has neither the right nor any legitimate expectation that the tax regime will not change****, perhaps to its disadvantage, during the period of the investment.*"[162]

In particular, this condition has its logical purpose for the investor simply cannot rely on the unchangeability of the law regime it operates under – not even in its home state. Hence, as regards the legitimate exercise of regulatory power of the state the *S.D. Myers* tribunal held that "*regulation is something that [investors] ought reasonably to expect. It generally does not amount to an unfair surprise*".[163]

In this context, however, for example the tribunal in *Waste Management* completely dismissed this notion and held in relation to "*the reasonably-to-be-expected economic benefit*" that "*the loss of benefits or expectations is not a sufficient criterion for an expropriation, even if it is a necessary one*"[164]

Additionally, some of the cases have even shown that such a focus on investor's expectations might disrupt the regulatory flexibility of the state's having a chilling effect on the state's regulatory activity.[165] Thus, based on the foregoing, it seems appropriate to include the legitimate expectations of the investors only in cases where those were given any specific commitments by the host state. As the *Waste Management* tribunal expressed regarding the

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[161] *Ibid*.

[162] *EnCana Corporation v. Republic of Ecuador*, LCIA Case No. UN3481, UNCITRAL (formerly EnCana Corporation v. Government of the Republic of Ecuador), Award, 3 February 2006, para 173.

[163] *S.D. Myers, Inc. v. Canada*, UNCITRAL, Partial Award, 13 November 2000, para 213.

[164] *Waste Management, Inc. v United Mexican States*, ICSID Case No. ARB(AF)/98/2, Award, 2 June 2000, para. 159.

[165] ANON., 2019. Iisd.org [online] [accessed. 3 . December 2019]. Available at https://www.iisd.org/sites/default/files/publications/int_investment_law_and_sd_key_cases_2010.pdf.

matter, "*it is not the function of the international law of expropriation to eliminate the normal commercial risks of a foreign investor*".[166]

2.1.4 Nature of the measures

Finally, few words must be mentioned regarding the purpose or intent of the challenged measures on the grounds of indirect expropriation. This aspect is usually recognized by the tribunals applying the police powers doctrine, under which the assessment of the legitimate exercise of the right to adopt laws and other measures is requisite.[167] Hence, the tribunals would often take into consideration the reasons and ambit of the adopted regulations.

This element is not particularly crucial when establishing indirect expropriation, but it is mostly important when the tribunal is distinguishing between a compensable indirect expropriation and non-compensable legitimate regulatory act.[168]

Nonetheless, sometimes the tribunals would also dig into the reasons behind the challenged measures in order to see whether there was any *mala fide* intention to deprive an investor of its property.

Thus, for example in the *Rusoro* case where the tribunal assessed an alleged occurrence of creeping expropriation it held that Venezuela was not anyhow following "*a hidden agenda to nationalise the private gold sector*".[169]

Contrarily, in the *Hulley Enterprises* case upon a thorough scrutiny of the challenged measures and the state's reasons for their adoption the tribunal held that the primary objective of Russia was not fulfil its legitimate fiscal sovereignty, but rather to cause the investor's bankruptcy.[170]

In conclusion, the *Yukos* tribunal also considered reasons lurking behind the state's actions and held that "*after having now traversed, at some length, the treatment of Yukos by Russian*

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[166] *Waste Management, Inc. v United Mexican States*, ICSID Case No. ARB(AF)/98/2, Award, 2 June 2000, para. 159.

[167] For further discussion see the Part "Right to Regulate and Indirect Expropriation", Section 3.2.

[168] UNCTAD II, p. 76.

[169] *Rusoro Mining Limited v. The Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/12/5, Award, 22 August 2016, paras. 427–438, pp. 101–103.

[170] *Hulley Enterprises Limited (Cyprus) v. The Russian Federation,* PCA Case No. AA 226*,* UNCITRAL, Final Award, 18 July 2014, para. 1579 et seq.

tax authorities, the bailiffs and the courts, and having considered the totality of the evidence, especially the VAT evidence, the Tribunal has concluded that ***the primary objective of the Russian Federation was not to collect taxes but rather to bankrupt Yukos*** *and appropriate its valuable assets*."[171]

2.2 Measures (not)found to be expropriatory

Although the investment tribunals have mostly decided in favour of the states, plentiful of the state's measures were also held to be expropriatory.[172] Those can be classified in accordance with their nature into several groups. According to *prof. Newcombe* and *prof. Sornarajah* this includes a wide variety of measures such as forced sales of property or shares, exorbitant or arbitrary taxation, taking over the management or control of a business enterprise, annulment and cancellation of property rights and necessary licenses or permits, total prohibition of the investor's business activity or of the access thereof to a key supplier or natural resources, other harassment such as freezing of bank accounts, lockouts and labour shortages as well as failure to provide protection for the investor's property against any other interference of third parties.[173] Similarly, the precise measures that are considered to amount to indirect expropriation were listed for example in the Award of *Pope &Talbot* case.[174]

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[171] *Yukos Universal Limited v. The Russian Federation*, PCA Case No. 226, UNCITRAL, Final award, 18 July 2014, para. 756.

[172] *Advanced Search | Investment Dispute Settlement Navigator | UNCTAD Investment Policy Hub* [online]. [Accessed 20 June 2019]. Available at https://investmentpolicy.unctad.org/investment-dispute-settlement/advanced-search.

[173] NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 327; SORNARAJAH, Muthucumaraswamy. *The International Law on Foreign Investment*. 3rd ed. New York : Cambridge University Press, 2010. P. 375.

[174] *Pope & Talbot v Canada*, UNCITRAL, Interim Award, 26 June 2000, para 100:

"*Investment has been nationalized or that the Regime is confiscatory. […] the Investor remains in control of the Investment, it directs the day-to-day operations of the Investment, and no officers or employees of the Investment have been detained […]. Canada does not supervise the work of the officers or employees of the Investment, does not take any of the proceeds of company sales (apart from taxation), does not interfere with management or shareholders' activities, does not prevent the Investment from paying dividends to its shareholders, does not interfere with the appointment of directors or management and does not take any other actions ousting the Investor from full ownership and control of the Investment*."

Moreover, as was concluded in *Enron* case this list of the measures is a representative of the legal standard required to make a finding of indirect expropriation.

Contrarily, in many more cases the state's measures such as omissions and legitimate changes in laws or rates of VAT exemptions did not reach the threshold of indirect expropriation.[175] Either it was because the investors failed to substantiate a significant adverse impact on the investment thereof or the state's measures were not capable of amounting to indirect expropriation in the first place.

The tribunals' insight helped to create a certain array of guidelines for assessing other measures from an indirect expropriation perspective. Nevertheless, for completion of the foregoing, the following has to be taken with a grain of salt due to the fact that no matter how the states' measures are similar in appellation, all the cases have different legal and factual backgrounds and were being resolved under different IIAs which can have a major impact on the tribunal's decision.

2.2.1 Withdrawal of licences, certificates and permits

One of the most frequently scrutinized measures before the international tribunals is an alleged withdrawal or non-renewal of licences or permits that are essential for the foreign investor's ability to conduct its business.[176]

What often happens is that upon the issuance of the license under which an investor is legitimated to operate its business, the state issues a decree or other regulation revoking such license, or even banning the given permitted activity.

That was the case, for instance, in *Cement Shipping* where the Claimant had been operating under a licence import, docking and dispatching cement in Egypt when, suddenly, the privileges granted thereto were de facto revoked by the Decree No. 195 prohibiting import

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Enron Corporation, Ponderosa Assets LP v. The Argentine Republic, ICSID Case No. ARB/01/3, Award, 22 May 2007, para. 245.

[175] MCLACHLAN, Campbell, SHORE, Laurence and WEINIGER, Matthew. *International investment arbitration substantive principles*. Oxford : Oxford University Press, 2017. P. 291, para. 8.71; for example, the *Encana* case.

[176] According to the investment policy hub almost one quarter of the cases of indirect expropriation, most of them decided in favour of states, many are still pending or were settled, many were however upheld in favour of the investor.

Advanced Search | Investment Dispute Settlement Navigator | UNCTAD Investment Policy Hub [online]. [Accessed 20 June 2019]. Available at https://investmentpolicy.unctad.org/investment-dispute-settlement/advanced-search.

of all kinds of Portland Cement.[177] The tribunal found a de facto revocation of the Claimant's license by the decree and Egypt's conduct thereafter expropriatory.[178]

Alternatively, indirect expropriation was also found in cases where the validity of a license or certificate was contingent on a regular renewal by the host state. In such cases, indirect expropriation was found where the State did not renew such license or permit without any reasonable ground.[179]

Lastly, several cases involved withdrawals of certificates or arbitrary refusal to grant a permit to the investor.[180] One of them was *Goetz* were the claim emerged from an alleged withdrawal of a certificate of free zone conferring tax and customs exemptions which was held to be a measure tantamount to expropriation "*depriving of or restricting property rights*."[181] Additionally, a case of expropriation was established in *Crystallex v. Venezuela*. Here, the Claimant, a gold mining company, was arbitrarily refused the necessary authorization after it was specifically reassured by the government that all the permits will be granted.

On the contrary, in some cases[182] a withdrawal or non-renewal of the licences were not deemed to amount to indirect expropriation either because the respective authorities were acting within their legitimate discretion in a non-discriminatory or there were breaches found on the part of the investors.[183]

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[177] *Middle East Cement Shipping and Handling Co. S.A. v Arab Republic of Egypt,* ICSID Case No. ARB/99/6, Award, 12 April 2002, para 82.

[178] *Ibid.,* para 107.

[179] See, for example, in the *Tecmed* case where Mexico rejected Claimant's request to renew the permit to operate a hazardous waste landfill which the tribunal found to be arbitrary and held the breach of expropriation; *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003.

[180] See, for example, *Metalclad*, *Goetz*, and *Crystallex.*

[181] *Antoine Goetz et consorts v. République du Burundi*, ICSID Case No. ARB/95/3, Award, 10 February 1999, para. 124;

"*mesures privatives et restrictives de propriété*".

[182] See, for example, *European Media Ventures SA v. The Czech Republic,* UNCITRAL; *Caratube International Oil Company LLP v. The Republic of Kazakhstan,* ICSID Case No. ARB/08/12; *Pac Rim Cayman LLC v. Republic of El Salvador, ICSID Case No. ARB/09/12*.

[183] *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID Case No. ARB/99/2, Award, 25 June 2001, para 363; „*In sum, the Tribunal finds that the Bank of Estonia* ***acted within its statutory discretion when it took the steps that it did, for the reasons that it did, to revoke EIB's license****. Its ultimate decision cannot be said to have been arbitrary or discriminatory against the foreign investors in the sense*

2.2.2 Exorbitant taxation and other tax measures

In the process of the conduct of international investment relations, taxation imposed upon foreign investors is an important and inherent part of the interaction between such investors and host states.[184] Hence, it is not surprising that a significant number of investment disputes have also revolved around the measures of taxation.[185]

The problem is, that, by their very nature, those measures are an appropriation of property for which no compensation is due, even if taxation reaches fifty or sixty percent (which is quite common in some of the host states).[186] Furthermore, by definition, taxation is a matter of achievement of other social and political objectives (e.g. support for domestic industry, redistribution of wealth, etc.) and ceding this attribute of the state's fiscal sovereignty to the scrutiny of international bodies would be deemed surrendering thereof which could curtail the states' discretion over the tax policy.[187] Consequently, tax measures are usually covered by reservations or exceptions clauses[188] excluding those measures from the scope of the respective

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in which those words are used in the BIT.89 The decision, as it turns out, was further justified by subsequent revelations and appears even more understandable with hindsight."

Liman Caspian Oil BV and NCL Dutch Investment BV v. Republic of Kazakhstan, ICSID Case No. ARB/07/14, Excerpts of Award, 22 June 2010, paras. 433-434; "*With regard to the action of the Ministry of Energy, the Tribunal agrees with* ***the reasoning of the Azinian tribunal*** *holding that a* ***governmental authority cannot be reproached for acting in accordance with a decision taken by the state's own courts****. This is at least so if, as found above, such court decisions are irreproachable and have to be accepted from the perspective of international law.*
For these reasons, the order of the re-transfer of the Licence to [X], which only executed the court decision, does not constitute an act which could be independently considered as an expropriatory measure."

[184] WALDE, Thomas, KOLO, Abba. Investor-State Disputes: The Interface Between Treat-Based International Investment Protection and Fiscal Sovereignty. *Intertax*,. 2007, 35(8/9), pp. 424–449. P. 424.

[185] According to the survey carried out by UNCTAD, as many as, 10% of the cases revolving around allegations of indirect expropriation resolved has been connected to either tax or VAT measures or other issues. For further details, please, see *Advanced Search | Investment Dispute Settlement Navigator | UNCTAD Investment Policy Hub* [online]. [Accessed 20 June 2019]. Available at https://investmentpolicy.unctad.org/investment-dispute-settlement/advanced-search.

[186] NEWCOMBE, Andrew and PARADELL, Lluis. NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 360.

[187] WALDE, Thomas, KOLO, Abba. Investor-State Disputes: The Interface Between Treat-Based International Investment Protection and Fiscal Sovereignty. *Intertax*,. 2007, 35(8/9), pp. 424–449. P. 431.

[188] For more detailed discussion, see the Part "General Exceptions".

IIAs making the assessment thereof very troublesome in the cases involving indirect expropriation allegations.

At the same time, however, such notion of the fiscal sovereignty provides for a certain passage of arbitrary, discriminatory and excessive tax measures. Thus, apart from the aforementioned denials, withdrawals or non-renewals of permits and licenses, the cases involving taxation measures were mostly decided in favour of the investors.[189]

One of the cases which involved a significant number of tax measures and was decided in favour of the aggrieved investor is *Tza Yap Shum*.[190] In this case, claims have arisen from seizure of the investor's bank account due to tax debt and other actions of Peruvian tax authorities such as tax assessment, tax audits and interim measures.[191]

The tribunal observed that:

"*under international law, a* ***State is not liable for the loss of value of property or for other economic disadvantages that result from the good faith imposition of general taxes****, regulations, or other conduct commonly accepted as part of the police powers of the state. The creation, administration, and collection of taxes form part of the taxation power of the states*."[192]

However, it also added that "*the imposition of taxation measures or their enforcement may be expropriatory if they are* ***confiscatory, arbitrary, abusive, or discriminatory.***" [193] On the grounds of which it held that Peru was liable for the adoption of the said measures.

Similar conclusion was reached by the tribunal in *Feldman* which dealt with the denial of benefits of a law that allowed certain tax refunds to the claimant. Although its reasoning, the tribunal concluded that *"non-discriminatory, bona fide general taxation does not establish liability"*, with the reference to the *Restatement (Third)* it also asserted that in some cases the taxation can ripen to expropriation.

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[189] *Advanced Search | Investment Dispute Settlement Navigator | UNCTAD Investment Policy Hub* [online]. [Accessed 20 June 2019]. Available at https://investmentpolicy.unctad.org/investment-dispute-settlement/advanced-search.

[190] *Señor Tza Yap Shum v. The Republic of Peru,* ICSID Case No. ARB/07/6, 7 July 2011.

[191] MINAS, Stephen. Julien Chaisse (ed.), China's International Investment Strategy: Bilateral, Regional, and Global Law and Policy. *Chinese Journal of International Law*. 2019, 18(3), pp. 723–726. p.1.

[192] *Señor Tza Yap Shum v. The Republic of Peru*, ICSID Case No. ARB/07/6,7 July 2011, para 173.

[193] *Ibid*., para 181.

A different situation appeared in *Hulley Enterprises*[194] where the claims stemmed from the tax measures imposed by Russia. Additionally, the tax measures were also accompanied by a series of actions which included criminal prosecutions, harassment of the investor, its employees and related persons and entities, massive tax reassessments, VAT charges, fines, asset freezes and other measures to enforce the tax reassessments, culminating jointly in the bankruptcy of the investor."[195] The tribunal made a thorough assessment of the measures altogether and the intention therebehind finding that the primary objective of Russia was not to fulfil its legitimate fiscal sovereignty, but rather to cause the investor's bankruptcy.[196]

On the other hand, in *EnCana* the tribunal rejected a claim based on the denial of VAT refunds by the government of Ecuador to two of the investor's subsidiaries.[197] The *EnCana* tribunal refused to find any case of expropriation based on these allegations and find the states' tax measures unreasonable. It held, referring to *Feldman* and the Restatement, that

> "*all taxation reduces the economic benefits an enterprise would otherwise derive from the investment; it will* ***only be in an extreme case that a tax which is general in its incidence could be judged as equivalent in its effect to an expropriation*** *of the enterprise which is taxed.*"[198]

Conformably with the foregoing, the tribunal in *ADM* has not found a case of indirect expropriation caused by adopted tax measures.

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[194] Similarly: *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 228 and RosInvestCo UK Ltd. v. The Russian Federation, SCC Case No. V079/2005.

[195] *Hulley Enterprises Limited (Cyprus) v. The Russian Federation,* PCA Case No. AA 226*,* UNCITRAL, Final Award, 18 July 2014, para 63.

[196] *Ibid*., para 1579 et seq.

[197] SUBEDI, P. Surya. *International investment law: reconciling policy and principle*. Oxford : Hart Publishing Ltd., 2016. P. 76.

[198] *EnCana Corporation v. Republic of Ecuador*, LCIA Case No. UN3481, UNCITRAL, Award, 3 February 2006, para. 173.

Interestingly, the tribunal also vastly referred to the *Revere Copper v. OPIC* case resolved before the domestic arbitration tribunal which revolved around the newly imposed taxation measures. [Award para. 175 *et seq.*] The *EnCana* tribunal found that however the cases might seem similar, in the *Revere Copper* case the tribunal was operating under a different IIA. Hence, *EnCana* tribunal explained that *Revere Copper* tribunal did not found the changes in tax law unlawful *per se*, contrarily, it held these changes were unlawful in the context of the stabilization clause present in the respective IIA. This precisely illustrates how the differently assembled IIAs can affect the outcome of the decision-making process of international investment tribunals even though the factual backgrounds of the cases can be similar.

After pointing out that the sole effects test is according to the doctrine a leading approach to the assessment of the cases of indirect expropriation, it came to the conclusion that "*the degree of interference caused by the Tax on the Claimants' investment does not amount to an indirect expropriation because: (i) the investors remained in full ownership and control of their investment […]; (ii) the investors remained in full possession and of their production […].*"[199]

Similarly, the denial of certain tax exemptions in *Albacora v. Ecuador* was not found to be expropriatory either.[200]

2.2.3 Other measures and harassment

Lastly, there are many more aspects of the foreign investor's business which the states can interfere with as well as many different tools which can be used to do so.

Thus, among other measures that were found to be expropriatory is an expulsion of the key figure for the investor inferred by an ad hoc tribunal ruling under UNCITRAL rules in *Biloune* case. [201] According to the tribunal Biloune was such an important entity that by his expulsion, together with other measures, the business was severely deprived:

> "*the conjunction of the stop work order, the demolition, the summons, the arrest, the detention, the requirement of filing assets declaration forms,* ***and the deportation of Mr. Biloune without possibility of re-entry*** *had the effect of causing the* ***irreparable cessation of work on the project****.* ***Given the central role of Mr. Biloune in promoting, financing and managing MDCL, his expulsion from the country effectively [constituted constructive expropriation]****.*"[202]

According to *prof. Sornarajah*, the so-called indigenisation measures also constitute indirect expropriation.[203] When these measures occur, a "*progressive transfer of ownership*

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[199] See *ADM v. Mexico*, ICSID CASE No. ARB(AF)/04/05, 21 November 2007, para 235.

[200] *Albacora, S.A. v. La República del Ecuador,* PCA Case No. 2016-11.

[201] Ad Hoc-Award of October 27, 1989 and June 30, 1990, Antoine Biloune (Syria) and Marine Drive Complex Ltd. (Ghana) v. Ghana Investment Centre and the Government of Ghana, YCA 1994, at 11 et seq. UNCITRAL.

[202] *Ibid.,* 26.

[203] SORNARAJAH, Muthucumaraswamy. *The International Law on Foreign Investment*. 3rd ed. New York : Cambridge University Press, 2010. P. 380.

from foreign interests into the hands of local shareholders" takes place which partly resembles the situations of direct seizure.[204]

Many cases have also involved a chain of measures where investors found themselves under a weight of harassment from the part of the respective host state. In fact, in investment arbitrations it is common that the claims revolve around several state's measures at time, rather than one measure, which either jointly or individually substantially affect the investment in question. However, in cases of "regulatory harassment" the variety of measures is adopted with one intention – to make the operation of the investor's business unbearable. In the *Hydro* case these measures included tax audit proceedings, seizure and sequestration of bank accounts and assets, money laundering investigations, and arrest warrants against individual claimants.[205] Likewise in *Stati* the harassment was designed to pressure the investors into selling their investments to the state-owned oil company by a combination of imprisonment of employees upon baseless criminal allegations, Financial Police investigations, fines, and tax threats.[206]

Finally, there was also a certain deliberation regarding the question whether omissions on the part of the host state, rather than actions, could constitute expropriation as well. According to *prof. McLachlan*, who mostly referred to the *Olguin* decision, inactivity of states is rather insufficient in order to stand a case of indirect expropriation no matter how egregious these omissions might be.[207] On the contrary, in the case *Eureko* the tribunal refused to follow such a restrictive point of view stating that "*it is obvious that the rights of an investor can be violated as much by the failure of a Contracting State to act as by its actions*."[208]

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[204] *Ibid*.

[205] *Hydro S.r.l. and others v. Republic of Albania*, ICSID Case No. ARB/15/28, Decision on Claimants' Request for a Partial Award and Respondent's Application for Revocation or Modification of the Order on Provisional Measures, 1 September 2016, para. 1.4 *et seq*.

[206] *Anatolie Stati, Gabriel Stati, Ascom Group SA and Terra Raf Trans Traiding Ltd v. Kazakhstan*, SCC Case No. V 116/2010, Award, 19 December 2013, para. 15.

[207] MCLACHLAN, Campbell, SHORE, Laurence and WEINIGER, Matthew. International investment arbitration substantive principles. Oxford : Oxford University Press, 2017. Pp. 381-382, paras. 8.71-8.72; *Olguín v Paraguay,* ICSID Case No ARB/98/5, Award, 26 Jule 2001, para 84.

[208] *Eureko B.V. v. Republic of Poland*, Ad Hoc Tribunal (UNCITRAL), Partial Award, 19 August 2005, para. 186.

3. INDIRECT EXPROPRIATION IN IIAS PRACTICE

Vast majority of IIAs, especially the modern ones, reflect the multifariousness of cases concerning the states' interference with foreign investors' property. As regards the two types of expropriation described previously, both direct and indirect expropriation (with certain exceptions[209]) are usually expressly included in the provisions concerning expropriation in contemporary IIAs.[210] Moreover, states recently started to include into IIAs annexes and protocols with further clarification of the state's conduct (not)amounting to indirect expropriation in a fairly thorough and detailed manner.[211]

Although both the ISDS practice and scholarly works failed to bring any uniform description concerning the measures that would constitute indirect expropriation, there are certain elements that are rather essential for "expropriation" provisions and appear in most of the IIAs.[212] According to UNCTAD, the provisions regarding expropriation commonly contain:

"*(i) definition of the concepts of direct and indirect expropriation;*

(ii) clarification that expropriation occurs with respect to tangible or intangible property rights and property rights in an investment;[213]

(iii) clarification that an assessment of indirect expropriation involves a case-by-case factual inquiry (which usually involves the assessment of an economic impact of the

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[209] See, for example, one of the most recent BITs, Brazil - Guyana BIT (2018), explicitly reads in its Art. 7 that it *"[...] only provides for direct expropriation, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or ownership rights, and does not cover indirect expropriation."*

[210] See, for example, Canada Model BIT (2014), Art. 13; German Model BIT (2008), Art. 4; Energy Charter Treaty 34 ILM 360 (1995), (2014), Art. 13; North American Free Trade Agreement NAFTA, 32 ILM 289, 605 (1993), Art. 1100; U.S.-Canada Free Trade Agreement CAFTA, 27 I.L.M. 281 (1988), Art. 1605;

"[…] *neither Party shall nationalize or expropriate a covered* ***investment either directly, or indirectly*** *[...]*".

[211] See, for example, Canada Model BIT (2014), Annex B.13(1); "*For greater certainty, Article 13(1) shall be interpreted in accordance with Annex B.13(1)* ***on the clarification of indirect expropriation***."

[212] APEC, Core Elements of IIAs: A Cross-regional Comparative Study, March 2010, Committees, CTI Sub-Fora & Industry Dialogues Groups, Investment Experts' Group (IEG), Committee on Trade and Investment (CTI), pp. 9-10; Accessed online [https://www.apec.org/Publications/2010/03/Core-Elements-of-IIAs-A-Cross-regional-Comparative-Study].

[213] See, for example, China-New Zealand FTA (2008), Art. 145; Annex 13

"Expropriation

1. An action or a series of actions by a Party cannot constitute an expropriation unless it ***interferes with*** *a* ***tangible or intangible property*** *right or property interest in an investment.".*

measure, interference with distinct and reasonable investment-backed expectations; and nature and characteristics of the measure);[214]

(iv) establish a presumption of the non-expropriatory nature with respect to non-discriminatory measures of general application designed and applied to protect public welfare objectives."[215]

3.1 Concepts of direct and indirect expropriation in IIAs

Typically, based on the chosen terminology in a treaty, modern IIAs can be divided into two categories. [216]

The first category commonly contains the wording that either mentions direct and indirect expropriation with no further elaboration or distinguishes expropriation and measures "equivalent to", "tantamount to" or "similar to" expropriation.[217]

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[214] See, for example, Eurasian Economic Union - Viet Nam FTA (2015); Article 8.35

"*Expropriation and Compensation*
The ***determination of whether a measure or series of such measures of either Party to this Chapter have an effect equivalent to nationalisation or expropriation*** *shall require a* ***case-by-case, fact-based inquiry*** *to consider, inter alia:*

a) the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of either Party to this Chapter has an adverse effect on the economic value of investments does not establish that an expropriation has occurred;
b) the character of the measure or series of measures of either Party to this Chapter."

[215] UNCTAD II, p. 72.

[216] NIKIÈMA, Suzy H. Best Practices Indirect Expropriation. *The International Institute for Sustainable Development (IISD).* 2012. P. 5

[217] See, for example, Armenia - Netherlands BIT (2005), Art. 6;
"*[…] any measures* ***depriving, directly or indirectly****, investors of the other Contracting Party […]*"

Czech Republic - Switzerland BIT (1990), Art. 6; China - Romania BIT (1994), Article 4.;
"*[…] expropriation or nationalisation or* ***similar measures/measures with similar effect*** *[…]*"

Czech Republic - Sri Lanka BIT (2011), Art. 5; Vietnam - Latvia BIT (1995), Art. 5;
"[…] nationalized, expropriated or subjected to ***measures having effect equivalent to*** *nationalization or expropriation […]"*

Japan - Saudi Arabia BIT (2013), Art. 9; Germany - Poland BIT (1989), Art. 4.2; Argentina - Greece BIT (1999), Art. 4; Israel - Estonia BIT (1994), Art. 5.1;
"[…] expropriate or nationalize investments of investors of the other Contracting Party ***or take any measure tantamount to*** *expropriation or nationalization […]".*

The second category of IIAs recognizes all the aforementioned terms together; meaning direct, indirect expropriation as well as other measures which are "tantamount to" or "equivalent to" expropriation or "have the same or similar effect" as expropriation.[218]

Some of those IIAs include the wordings "with the effect similar to expropriation" or "equivalent to expropriation" in order to further outline the measures which would constitute indirect expropriation.[219] Nevertheless, however this phrasing might seem necessary, according to practice it is not quite the case for investment tribunals usually assess the host state's measures under the so called "effects test" regardless the occurrence of such wording in IIA.[220]

Interestingly, and this may be counted also as the third *sui generis* category, wordings of some of the oldest IIAs (specifically the ones with Germany) referring only to expropriation with no further clarification were subsequently amended by protocols explicating the terms used therein. [221] Such can be deemed the first reflection on the changing concept of expropriation.

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[218] See, for example, North American Free Trade Agreement NAFTA, 32 ILM 289, 605 (1993), Art. 1100;

"1. No Party may ***directly or indirectly nationalize or expropriate*** *an investment of an investor of another Party in its territory* ***or take a measure tantamount to*** *nationalization or expropriation of such an investment ("expropriation"), except […].";*

U.S.-Canada Free Trade Agreement CAFTA, 27 I.L.M. 281 (1988), Art. 10.7

"No Party may ***expropriate or nationalize*** *a covered investment* ***either directly or indirectly through measures equivalent to*** *expropriation or nationalization ("expropriation"),[…].";*

BLEU (Belgium-Luxembourg Economic Union) - Libya BIT (2004), Art. 7;

"[…] not to adopt any measure of ***expropriation or nationalisation or any other measure having the effect*** *of* ***directly or indirectly dispossessing*** *the investors of the other Contracting Party of their investments in its territory.".*

[219] See, for example, Egypt - Finland BIT (2004), Art., 5; Kenya - Switzerland BIT (2006), Art. 6.

[220] MEG, Kinnear N., BJORKLUND, Andrea K., and HANNAFORD, John F. G. *Investment disputes under NAFTA: An Annotated Guide To NAFTA.* 2006 Alphen aan den Rijn, The Netherlands: Kluwer Law International. P. 1110-15.

[221] Germany - Pakistan BIT (1959); Germany - Malaysia BIT (1960);

Those treaties, at the first place, commonly read *"[Investor] of either Party shall not be subjected to expropriation of their investments […] except for […].";*

The protocols then specified that *"The term "expropriation" […] shall also pertain to acts of sovereign power which are tantamount to expropriation, as well as measures of nationalization.".*

3.2 Recent trends in treaty practice concerning indirect expropriation

Contemporary trends in treaty practice seem to be revolved around two main matters.[222] Firstly, many recent IIAs started to reflect the need for closer specification of measures that fall within the scope of indirect expropriation. Secondly, many modern IIAs affirm and further adjust the state's right to regulate in public purpose (especially regarding environmental and health issues) in connection with the phenomenon of indirect expropriation.

3.2.1 Guidelines on the assessment of indirect expropriation

Plenty of recent treaties took the step towards greater clarification and specification of the relevant indicators of what measures constitute indirect expropriation. [223]

To some degree, clarification concerning the assessment of attributes of measures amounting to indirect expropriation appeared in the late 70s when the parties to IIAs began to conclude protocols that further delineated certain provisions thereof.[224]

For instance, 1979 *Germany - Romania BIT Protocol* explained that

> "*"Expropriation" shall mean any kind of official measures that withdraw or restrict right of ownership or any other rights constituting a capital investment or part of a capital investment, as well as any other official measures that in their effect on the investment are tantamount to an expropriation*."[225]

Interestingly, 1984 *Congo - US BIT Protocol* provided rather detailed description by stating:

> *"Direct or indirect measures tantamount to expropriation as used in Article III(l) may include the levying of taxes equivalent to indirect expropriation, the compulsory sale of all or part of an investment, or the impairment or deprivation of the management, control, or economic value of an investment"*.[226]

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[222] UNCTAD II, p. 22.

[223] UNCTAD II, p. 57.

[224] DOLZER, Rudolph and STEVENS, Margrete. Bilateral Investment Treaties. The Hague : Martinus Nijhoff, 1995. P 101.

[225] Germany - Romania BIT (1979), *Protocol,* p.386, para. 2.

[226] Democratic Republic of the Congo – United States of America BIT (1984); *Protocol*, p.18, para. 5.

Current IIAs, in order to describe the attributes of indirect expropriation, commonly use either explanatory sections to articles concerning expropriation or annexes (usually in more extensive multilateral agreements).[227]

Annexes and explanatory sections usually have fairly similar wordings and very often unanimously call for a case-by-case, fact-based inquiry.[228] Additionally, they provide with a list of several relevant factors that need to be taken into account in order to decide whether or not a measure constitutes an indirect expropriation.

For instance, Annex 1 of 2018 EU - Singapore Investment Protection Agreement reads as follows:

> "*The **determination […] requires a case-by-case […] inquiry** that considers, among other factors:*
>
> *(a) the **economic impact of the measure** or series of measures and its **duration**, although the fact that a measure or a series of measures by a Party has **an adverse effect** on the economic value of an investment, standing alone, **does not establish that an indirect expropriation has occurred**;*
>
> *(b) the **extent to which** the measure or series of measures **interferes with the possibility to use, enjoy or dispose of the property**; and*
>
> *(c) the **character of the measure** or series of measures, notably its **object, context and intent**.*"[229]

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[227] In case of annexes, the treaties usually include general provisions concerning expropriation with identification of direct and indirect expropriation, other terms as well as requirements for the takings to be lawful. The footnotes under those provisions then refer to the annexes stating that *"[Article] shall be interpreted in accordance with Annex [XY]"*.

[228] See, for example, Australia - Indonesia CEPA (2019), Annex 14-B, para.3; ASEAN - Hong Kong, China SAR Investment Agreement (2017), Annex 2, para.3; Trans-Pacific Partnership (2016), Annex 9-B, para. 3; Chile - Hong Kong, China SAR BIT (2016), Annex 1, para. 3;

"The determination of whether a measure or series of measures by a Party, in a specific situation, constitutes an indirect expropriation requires a case-by-case, fact-based inquiry that considers […]".

[229] Similarly see, for instance, China – Republic of Korea FTA (2015), Annex 12-B; Australia – Indonesia CEPA (2019), Annex 14-B; Argentina – Japan BIT (2018), Art. 11, Section 3; China – United Republic of Tanzania BIT (2013), Art.6; Armenia – Singapore Agreement on Trade in Services and Investment (2019), Annex 3-A.

These factors are sometimes referred to as the three-prong "*Penn Central test*", since they originated from the doctrine developed by the US Supreme Court.[230]

3.2.2 Reaffirmation of the state's right to regulate and general exceptions in IIAs

Contemporary trends in treaty practice also include provisions confirming and recognizing the state's right to regulate.[231] The rationale behind is mostly the fact that certain regulatory measures of states needed to be excluded from the scope of compensable expropriations as otherwise the states internationally recognized right to regulate could be overly curtailed.[232]

Generally, those provisions set forth that "*none of the provisions in the treaty shall prevent any of the contracting States from taking measures that protect certain public interests (e.g., public health, human, animal or plant life, the environment, national security, maintenance and improvement of labour rights, etc.)".*[233]

The two following Parts of the thesis – on the states' right to regulate and general exceptions clauses in IIAs – will provide with more thorough discussion regarding the matter.

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[230] BURGHETTO, María, Beatriz and LORFING, Pascale, Accaoui. The Evolution and Current Status of the Concept of Indirect Expropriation in Investment Arbitration and Investment Treaties. *Indian Journal of Arbitration Law*. 2017, VI (2), pp. 98 -123. P.100; See also Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104 (1978).

[231] BÜCHELER, Gebhard. *Proportionality in investor-state arbitration*. 1st ed. Oxford, United Kingdom : Oxford University Press, 2015. P.122.

[232] For further discussion, see the following Part of this thesis.

[233] See, for example, Australia - China FTA (2015), Article 9.8; Finland-El Salvador BIT (2002), Article 14; Gabon-Turkey BIT (2012), Article 5.

RIGHT TO REGULATE AND INDIRECT EXPROPRIATION

1. THE STATE'S FREEDOM TO REGULATE

The idea of the state's police powers or the capability to regulate its own internal matters has a very long historical development. The term police powers itself originates from the Latin "*pŏlītīa*"[234] which can be described as "*the administration of the Commonwealth*".[235]

According to *Adam Smith,* who gave his lectures at the University of Glasgow in the 18th century*,* the right to regulate signified "*the regulation of the inferiour parts of government"* which in detail *de facto* comprehended:

> "*the regulations made in order to preserve cleanliness of the roads, streets, etc. and prevent the bad effects of corrupting and putrifying substances;[…] the security of the people [by] preventing all crimes and disturbances which may interrupt the intercourse or destroy the peace of the society by any violent attacks[…].*"[236]

It follows that this conception of the regulatory power has not changed a lot since the 18th century scholarly writings as in its widest understanding it still encompasses "*regulation, discipline, and control of the community, its civil administration and the maintenance of public order*."[237]

As regards the contemporary connotation of the term, the *Black's law dictionary* describes the right to regulate as

> "*[an] inherent and plenary* ***power of a sovereign to make all laws necessary*** *and proper to preserve the public security, order, health, morality, and justice. It is a* ***fundamental***

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[234] LEGGARE, Santiago. The Historical Background Of The Police Power. *Journal of Constitutional Law.* 2002, 9(3), 745-796. P. 748.

[235] LEWIS, Charlton T., SHORT, Charles. *A Latin Dictionary Founded on Andrews' Edition of Freund's Latin Dictionary* [online]. Oxford: Oxford University Press, 1956. [Accessed on 3.11.2019] from Perseus Digital Library http://www.perseus.tufts.edu/hopper/text?doc=Perseus%3Atext%3A1999.04.0059%3Aentry%3Dpolitia.

[236] SMITH, Adam. *The Glasgow edition of the works and correspondence of Adam Smith*. Indianapolis, IN : Liberty Fund, 1982. P. 331.

[237] LEGGARE, Santiago. The Historical Background Of The Police Power. *Journal of Constitutional Law.* 2002, 9(3), 745-796. P. 761.

power essential to government, and it cannot be surrendered *by the legislature or irrevocably transferred away from the government*."[238]

Concerning the term "*power of a sovereign*", the sovereignty of states is generally characterized as a conglomerate of "***powers and privileges*** *resting* ***on customary law*** *which are* ***independent of the particular consent*** *of another state*".[239] According to *prof. Crawford* the concept thereof represents a "*basic constitutional doctrine of the law of nations, which governs a community consisting primarily of states having, in principle, a uniform legal personality*".[240]

As appositely explained Judge Weiss in his dissenting opinion in the *Lotus* case, the sovereignty is a paramount rule of international law that does not require to be embodied in any treaty for *"if the states were not sovereign, no international law would be possible"*.[241] Accordingly, an exercise of the state's sovereign power cannot be nullified by any treaty.[242] Thus, for instance in the case *Wimbledon* the PCIJ declined "*to* ***see in the conclusion of any [t]reaty*** *by which a [s]tate undertakes to perform or refrain from performing a particular act* ***an abandonment of its sovereignty***" as "*[t]he right of entering into international engagements* ***is an attribute of state sovereignty***."[243]

Essentially, it is a commonly accepted principle of international law that the states as sovereigns are endowed with the right to regulate.[244] As a matter of fact, the state's internal

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[238] GARNER, Bryan. *Black's Law Dictionary*. 10th ed. United States of America : Thomson Reuters, 2014. P. 1344. [*entry to "police powers"*]

[239] CRAWFORD, James. *Brownlie's principles of public international law.* 8th ed. Oxford: Oxford University Press. 2012. P. 448; HERDEGEN, Mathias. *Principles of International Economic Law*. 2nd ed. Oxford : Oxford University Press, 2016. P. 77.

[240] CRAWFORD, James. *Brownlie's principles of public international law.* 8th ed. Oxford: Oxford University Press. 2012. P. 447.

[241] As was mentioned in Lotus case by Judge Weiss: *"**[Sovereignty] does not even require to be embodied in a treaty:** that is the rule sanctioning the sovereignty of States. If States were not sovereign, no international law would be possible, since the purpose of this law precisely is to harmonize and reconcile the different sovereignties over which it exercises its sway."* (The Case of the S.S. 'Lotus', France v Turkey, PCIJ Series A, No. 10, 4, Dissenting Opinion of Judge Weiss, 7 September 1927, para. 121).

[242] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P. 103**.**

[243] *The SS 'Wimbledon', United Kingdom and ors v Germany*, PCIJ Series A no 1, ICGJ 235 (PCIJ 1923), Judgment, 17th August 1923, League of Nations (historical) [LoN]; Permanent Court of International Justice (historical) [PCIJ]. Para. 35.

[244] SORNARAJAH, Muthucumaraswamy. *The International Law on Foreign Investment*. 3rd ed. New York : Cambridge University Press, 2010. P. 367; DERAINS, Yves and SICARD-MIRABAL, Josefa. Chapter 5: Expropriation. In: *Introduction to Investor-State Arbitration*. Alphen aan den Rijn : Wolters Kluwer, 2018, pp.

regulatory activity within the ambit of its territory is perceived as a rule of customary international law[245] and deemed to be a crucial attribute of the state's sovereignty.[246] Referring to the decision of the *Fisheries Case*, the state's right to regulate is one of the "*essential elements of sovereignty… to be exercised within territorial limits*."[247]

From the conceptual point of view, the idea of the state's right to regulate represents an "*affirmation of states' authority to act as sovereigns on behalf of the will of the people*" in order to adjust the most important aspects of the existence of society.[248] It is thus within the state's sovereign power to adopt regulations that are deemed necessary or beneficial for any of the society-wide objectives.[249] In general, it refers to all forms of domestic regulation such as laws or statutes, regulations, directives and other acts of the legislature as well as the executive.[250] In practice, it usually covers ordinary measures concerning taxation, antitrust, consumer protection, securities and general measures regarding protection of public health or environment.[251]

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115 – 132. P. 115; The North Atlantic Coast Fisheries Case (Great Britain v United States of America), PCA Case No. XI RIAA 167, Award 7 September 1910, para. 174.

[245] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019, ISBN 978-94-035-0625-8. P. 107; The existence of the right to regulate has been mostly regarded as a rule of customary international law. See, for example, *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 119; *Saluka Investments B.V. v The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para. 262; *Marvin Roy Feldman Karpa v. United Mexican States, ICSID Case No. ARB(AF)/99/1* (also known as Marvin Feldman v. Mexico), Award, 16 December 2002, 103; *Methanex Corporation v. United States of America*, UNCITRAL, Final Award, 3 August 2005, para. 410.

[246] See, for example, *Oscar Chinn Case* (1934) PCIJ Series A/B No. 63.

[247] *The North Atlantic Coast Fisheries Case*, (Great Britain / United States of America), PCA Case No. 1909-01, Award, 7 September 1910, p. 181.

[248] MOUYAL, Lone Wandahl. *International investment law and the right to regulate: a human rights perspective*. New York : Routledge, 2018. P.8.

[249] *Ibid*. P.31.

[250] NEWCOMBE, Andrew. The Boundaries of Regulatory Expropriation in International Law. *ICSID Review – Foreign Investment Law Journal*. 20 (1), 2005, pp. 1-57. P. 26.

[251] SORNARAJAH, Muthucumaraswamy. *The International Law on Foreign Investment*. 3rd ed. New York : Cambridge University Press, 2010. P. 374.

Concludingly, due to its customary origin and an inherent connection to the state's sovereignty, the existence of the right to regulate should not be questioned "***unless one is aiming at the total dissolution of state functions***".[252]

Following all the foregoing, the question is not whether at all the states are allowed to make the necessary regulations, but what has to be rather examined is whether the state's right to regulate has its place within the network of IIAs and if affirmative, then where are the limits of an execution thereof.

Precisely, the questions begin to swarm when we stop thinking about the existence of the right to regulate and the concept thereof in a terminological "vacuum" (i.e. without other variables involved), but, on the other hand, in relation to other parallel maxims, rights and concepts. Firstly, it is important to state that in the realm of international law the states do not exist as isolated entities but rather as interrelated "partners" which are concluding different kinds of international instruments such as treaties or agreements. Hence, neither the concept of sovereignty nor the state's right to regulate as its component must be understood as absolute, i.e. unfettered and unretractable maxims.[253]

According to *prof. Seidl-Hohenveldern*, the notion of absolute sovereignty as it had existed since the Middle Ages has already outgrown itself, being transformed into the "relative sovereignty" under the connotation of which also other rules are allowed to govern the reciprocal relations between the states.[254]

Thus, speaking in the context of international investment law, by concluding IIAs the states are inevitably accepting limitations upon their sovereignty.[255] Otherwise, if the states would refuse such point of view and insisted on the fact that the international investment protection is in violation of their sovereignty, we would be back in times of the absolute

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[252] VICUÑA, Francisco Orrego. Regulatory Authority and Legitimate Expectations: Balancing the Rights of the State and the Individual under International Law in a Global Society. *International Law Forum du droit international*. 2003. 5(3), pp.188-197. P. 192.

[253] HERDEGEN, Mathias. *Principles of International Economic Law*. 2nd ed. Oxford : Oxford University Press, 2016. P. 78.

[254] SEIDL-HOHENVELDERN, Ignaz. *International economic law: general course on public international law*. Dordrecht : M. Nijhoff, 1987. 19,20.

[255] SUBEDI, P. Surya. *International investment law: reconciling policy and principle*. Oxford : Hart Publishing Ltd., 2016. P. 161.

sovereignty, i.e. the Middle Ages, with essentially no international relations possible whatsoever.[256]

As was fittingly concluded in the *Texaco* case, upon assuming international obligations through the means of miscellaneous written legal documents, a state simply cannot

> "*invoke its sovereignty to disregard commitments [...] and cannot, through measures belonging to its internal order, make null and void the rights of the contracting party which has performed its various obligations under the contract*."[257]

In fact, as the state's right to adopt laws stems from its sovereign power, the right to regulate ends where ends the sovereignty thereof.[258]

Following the aforesaid, the latest development shows that an apple of discord is hidden in the very relationship between the public and private interests; between the state's right to regulate and, in a way, exorbitant protection of the investors. Many questions regarding the state's right to regulate within international investment law was brought to the spotlight, as it became indispensable to delineate the state's legislative discretions and the protection of the investors' proprietary rights.[259]

Before proceeding further, at this point of the discussion on the matter at hand, it seems rather felicitous to stop with a brief "interpretative intermission".

For the sake of clarity, it bares noting that sundry scholars, while addressing the states' ability to adopt laws, often use the terms "regulatory freedom", "freedom to regulate", "police powers" and "right to regulate" interchangeably.[260] Thus, in order to preserve clear and

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[256] SEIDL-HOHENVELDERN, Ignaz. *International economic law: general course on public international law*. Dordrecht : M. Nijhoff, 1987. P. 65.

[257] *Texaco Overseas Petroleum Company v. The Government of the Libyan Arab Republic*, Ad Hoc Award, 19 January 1977, paras. 66-68, in FARUQUE, Abdullah. Validity and Efficacy of Stabilisation Clauses; Legal Protection vs. Funclional Value. *Journal of International Arbitration*. Netherlands : Kluwer International. 2006, 23(4), 317-336. P. 324.

[258] BÖRNER, Andreas. *Simple Truths on the Right to Regulate and the Duty to Pay*. *German Arbitration Journal*. Kluwer Law International; Verlag C.H. Beck oHG. 2017, 15(1), pp. 2 – 11. P. 3

[259] TITI, Catharine. *The right to regulate in international investment law*. Baden-Baden : Nomos, 2014. P. 19.

[260] See, for example RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. Pp. 7-20. P. 7; SORNARAJAH, Muthucumaraswamy. *The International Law on Foreign Investment*. 3rd ed. New York : Cambridge University Press, 2010. P. 274; OECD. "Indirect Expropriation" and the "Right to Regulate" in International Investment Law". *OECD Working Papers on International Investment.* 2004, 2004(04), 22pp. Paris: OECD Publishing.

consistent terminology when referring to the state's police powers or regulatory freedom, this thesis hereinafter stays with the term "right to regulate".[261]

2. RIGHT TO REGULATE IN THE CONTEXT OF INDIRECT EXROPRIATION

In the introduction of the following chapter, it appears to be apposite to borrow as an underpinning thought the question expressed by *prof. Lowe* in his article concerning the relationship of regulatory and expropriatory activities:

> "*How far do governments have to 'buy back' from foreign investors the right to regulate their economies?*"[262]

Following the aforesaid, the phenomenon of indirect expropriation is indeed very complex with many loopholes to be still covered. Nevertheless, the main thought behind the concept of indirect expropriation is rather clear – protecting investors' proprietary rights from not only direct seizure of investment but also from covert takings caused by miscellaneous regulatory measures whether separately or in conjunction with each other.

Putting it simply, indirect expropriation is usually found where the state's regulatory activity interferes with an investment so severely that the enjoyment or use thereof is rendered practically impossible.[263] Consequently, the state is held liable for such regulations and thus is obliged to compensate the aggrieved investor.[264] In order to find the state's measures expropriatory the tribunals and scholars were often satisfied with the sole presence of an adverse impact on the investment; no formal transfer of the property, no *mala fide* intention of the state to expropriate, not even the presence of the state's enrichment was required in order to establish indirect expropriation. Such an approach gave the tribunals vastly extensive adjudicative power

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[261] Although the term police powers is probably used the most in order to address the state's legislative power, in this case it was necessary to distinguish it against the term "police powers doctrine", which is discussed later in this Part of the thesis.

[262] LOWE, Vaughan. Regulation or Expropriation?. *Current Legal Problems*. 2002, 55(1), 447–466. P. 459.

[263] BLACKABY, Nigel, PARTASIDES, Constantine, REDFERN, Alan and HUNTER, Martin. *Redfern and Hunter on international arbitration*. 6th ed. Oxford, United Kingdom : Oxford University Press, 2015. P.471.

[264] MARBOE, Irmgard. *Calculation of compensation and damages in international investment law*. 2nd ed. Oxford : Oxford University Press, 2012. P.43, para 3.05.

while also expanded the protection of the investors at the expense of regulatory powers of the states.[265]

Conversely, in consideration of the foregoing, what if the need for adoption of a regulation stems from the state's international obligations or is imperative in order to preserve the state's security, health or environment? Alternatively, what if the regulatory actions are actually regulatory "reactions" induced by the commercial activity of the said investor substantively jeopardizing the state's economic sector or environment, health and other important objectives? Would it still be fair and reasonable to require the state to compensate in these cases?

With that in mind, the other no less important side of the coin called "indirect expropriation" is the protection of the state's regulatory activity which currently appears to be fairly oppressed by the investors' protection under the concept of indirect expropriation.[266]

In the contemporary industrialized world, the states have to have the possibility to remain flexible legislature in order to protect environment, health, other important objectives as well as meet their obligations stemming from miscellaneous international agreements and treaties.[267] And of course, in the process of fulfilling such obligations and protecting the society-wide interests, the state's measures can often have adverse effects on foreign investors which in turn leads to the claims brought before the respective investment tribunals against such host states.[268]

Consequently, the developments in international investment area inevitably led to the escalating tension between the concept of indirect expropriation and the state's right to regulate.[269] As the aftermath, according to *prof. Choukroune* this matter has acquired certain prominence due to the gravity thereof and as a corollary of many disputes brought before the

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[265] SHIRLOW, Esmé. Deference and Indirect Expropriation Analysis in International Investment Law: Observations on Current Approaches and Frameworks for Future Analysis. *ICSID Review*. 2014, 29 (3), pp. 595–626. P. 596.

[266] SORNARAJAH, Muthucumaraswamy. *The International Law on Foreign Investment*. 3rd ed. New York : Cambridge University Press, 2010. P. 372.

[267] BEEN, Vicki and BEAUVAIS, Joel C. The Global Fifth Amendment? NAFTAs Investment Protections and the Misguided Quest for an International Regulatory Takings Doctrine. SSRN Electronic Journal. 1 April 2002. Vol. 78:30. P. 42.

[268] DERAINS, Yves and SICARD-MIRABAL. Josefa, Chapter 5: Expropriation. In: *Introduction to Investor-State Arbitration*. Alphen aan den Rijn : Wolters Kluwer, 2018, pp. 115 – 132. P. 122.

[269] TITI, Catharine. *The right to regulate in international investment law*. Baden-Baden : Nomos, 2014. P. 68.

investment tribunals on the grounds of strict economy, taxation or environment regulatory measures.[270]

The truly crucial issue in modern international investment law revolving around the relationship between indirect expropriation and regulatory freedom is that the line therebetween has not been clearly defined.[271] That is partly caused by the everlasting problem lurking in the very divergence of the public and private interests, of the states' and investors' rights. It is as sure as death and taxes that the investors will endeavour to keep the scope of the concept of indirect expropriation as extensive as possible; the states, on the contrary, will strive to narrow its limits by expanding the scope of their non-compensable regulatory activities.[272] Furthermore, the lack of guidelines for delineation of the borderlines between these interests aggravates the situation. To be more accurate, it is very uncertain to what extent are the states able to adjust their internal issues by the means of regulations before triggering responsibilities under IIAs, i.e. the subsequent obligation to compensate the aggrieved investors.[273]

Hence, the scholars, arbitrators and states have recently started to pursue the balanced approach to the matter which would support the general right of states to regulate on one hand and help preserving the high standard of the investors' protection.[274] Most of all, the states started to include more sophisticated provisions in their IIAs not only as regard the scope of the concept of indirect expropriation but also certain reservations and exceptions that further reaffirm their right to regulate.

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[270] CHOUKROUNE Leïla. *Judging the State in International Trade and Investment Law Sovereignty Modern, the Law and the Economics*. Puchong, Selangor D.E. : Springer Singapore, 2018. P. 131.

"Whether the host country's regulatory measures ***result in indirect expropriation is a question that has acquired prominence due to a range of sovereign regulatory*** *functions being challenged as acts of expropriation by different foreign investors under BITs in the past decade or so. This includes* ***expropriation cases against Argentina*** *for adopting regulatory measures to save itself from an extremely severe economic and financial crisis,* ***claims of expropriation for environment-related regulatory*** *measures, re****gulatory measures aimed at addressing supply of drinking wate****r, **regulatory measures involving sovereign functions like taxation**, regulatory measures related to telecom policy and other cases."*

[271] DERAINS, Yves and SICARD-MIRABAL, Josefa. Chapter 5: Expropriation. In: *Introduction to Investor-State Arbitration*. Alphen aan den Rijn : Wolters Kluwer, 2018, pp. 115 – 132. P. 122; UNCTAD II, p. 91.

[272] DOLZER, Rudolf, SCHREUER, Christoph. Principles of International Investment Law. 2 ed. Oxford : Oxford University Press, 2012. P. 45.

[273] LOWENFELD, Andreas F. *International Economic law*. Oxford : Oxford University Press, 2018. P. vi.

[274] See, for example, ALVAREZ José E. The public international law regime governing international investment. The Hague : Hague Academy of International Law, 2011. P. 280.

Some of the tribunals have also developed certain tests and approaches which were to distinguish the expropriatory and regulatory measures.[275] However, no versatile approach has been discovered yet. In fact, as was addressed, for example, in *El Paso* case "*no absolute position can be taken in such delicate measures, where contradictory interests have to be reconciled*".[276]

The aggravating factor in this case appears to be hidden exactly in the practice of IIAs. The so far prevailing treaty practice was based on including considerably "open" provisions regarding expropriation thus causing that the investors started to extend the application of the concept of indirect expropriation to almost any regulatory act (even omissions) that had an impact on their investment.[277]

Thereofe, one of the questions that has lately arisen is whether the network of IIAs is not in fact detrimental for the state's right to regulate.[278] As a matter of fact, the debate that has appeared concerns the broader impact of IIAs on government regulations and changes to the laws.[279] Followingly, many scholars have also expressed their concerns as regards the so called "*regulatory chill*" which basically encompasses the states' reluctance to adopt laws due to the prospective claims which can be brought before the international tribunals.[280] According to the

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[275] For example, the three-prong reasoning test or the two-step test introduced by *Paulson & Douglas*. Further see MONTT, Santiago. *State Liability in Investment Treaty Arbitration; Global Constitutional and Administrative Law in the BIT Generation*. 2012. Oxford and Portland : Hart Publishing. P. 236;

Or a twostep test introduced by *Isakoff*, which aspires to aid the situations where the cases could have the chilling effect on the state's right to regulate. See, ISAKOFF, Peter David. Defining the Scope of Indirect Expropriation for International Investments. *Global business law review*. 2013, 3(2), pp. 189-209. P. 204.

[276] *El Paso Energy International Company v. The Argentine Republic*, ICSID Case No. ARB/03/15, Award, 31 October 2011, para. 234.

[277] SUBEDI, P. Surya. *International investment law: reconciling policy and principle*. Oxford : Hart Publishing Ltd., 2016. P. 76; SORNARAJAH, Muthucumaraswamy. *The International Law on Foreign Investment*. 3rd ed. New York : Cambridge University Press, 2010. P. 373

"*The* ***expansionary view of expropriation has already begun to cause concern*** *to the developed states, which now find themselves defendants in expropriation claims based on such broad views on expropriation*".

[278] GAUKRODGER, David. The Balance between Investor Protection and the Right to Regulate in Investment Treaties: A Scoping Paper. *SSRN Electronic Journal*. 2017. P. 21 *et seq*; ALVAREZ José E. *The public international law regime governing international investment*. The Hague : Hague Academy of International Law, 2011. P. 367.

[279] *Ibid*. P. 21.

[280] The matter of regulatory chill is addressed below in the present Part of the thesis discussing the treaty practice regarding the right to regulate.

Feldman tribunal the states would not be able to achieve any legitimate and reasonable regulations if any business that is adversely affected could seek compensation.[281]

As has been shown so far, there are many questions and interests involved concerning the matter. Nonetheless, it seems that the relationship between the state's right to regulate and indirect expropriation in international investment law boils down to several essential issues which ought to be addressed. Firstly, has the state's right to regulate as a concept of customary law any capability of being recognized within the network of IIAs? Secondly, how should then be addressed the emerged dichotomy between different state's acts, i.e. between regulatory and expropriatory measures? Alternatively, where should the threshold delineating those measures reside? Thirdly, would the implementation of such a threshold mean that the measures considered regulatory were non-compensable?

2.1 Treaty vs. customary law

The previous Chapters have described the state's right to regulate as a concept of customary law while indirect expropriation, being the concept emerging from the law of IIAs, could be seen as a treaty norm. Given this, it is absolutely essential to initially deal with the question whether the network of IIAs does not preclude the application of a norm of customary law such as the right to regulate. More specifically, whether the right to regulate as a concept rooted in the state's sovereignty (and thus in international customary law) could be, as a matter of fact, inferior to the network of IIAs.[282]

Primarily, it is necessary to establish whether the regime of such a network falls within general international law.

The point is, that the complex of IIAs is sometimes deemed to have created a "self-contained" system establishing itself a specialized regime outside general international law.[283] Many scholars, however, hold the opposite view. As was concluded for example by *Newcombe & Paradell* "*IIAs are not regarded as self-contained* ***with the risks of fragmentation in***

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[281] *Marvin Roy Feldman Karpa v. United Mexican States, ICSID Case No. ARB(AF)/99/1* (also known as Marvin Feldman v. Mexico), Award, 16 December 2002, para. 103.

[282] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P. 133 *et seq*.

[283] *Ibid*., Pp. 136-137.

***international law**, but rather systemically integrated within the international legal system*".[284] Nevertheless, even if the network of IIAs created a "self-contained" system this term should neither be used to "*circumscribe the hypothesis of a fully autonomous legal subsystem*" nor should it be read in a "*clinical isolation from general international law*".[285]

The rationale behind this statement is that the law of IIAs cannot be considered as an isolated system that would abide by its own logic and rules as the interpretation as well as application of IIAs is not independent from the overall features of general international law.[286] In fact, according to *prof. McLachlan* customary international law does intersect with the law of IIAs for instance by "*shedding light on the meaning of the terms used by the treaty, stipulating rules or maxims of interpretation, delimiting the bounds of the state's responsibility and giving content to the international minimum standard of treatment*".[287]

As affiliation and interconnection of the IIAs' network to general international law has been established, it is necessary to clarify whether the concept of the right to regulate could be indeed inferior to the network of IIAs.

In fact, there is more into this issue than meets the eye as the exact relationship between the treaty practice in international investment law and the concept of sovereignty as the customary law is not fully and clearly resolved.[288]

Primarily, it would be convenient to mention Article 38(2) of the *Statute of the International Court of Justice* which lays down the sources of international law.[289] Many scholars have sided with the opinion that the ordering of the aforementioned sources implies

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[284] NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 110.

[285] SIMMA, Bruno and PULKOWSKI, Dirk. Of Planets and the Universe: Self-contained Regimes in International Law. *The European Journal of International Law*.2006, 17(3). P. 492.

[286] DUPUY, Pierre Marie. Chapter 16: Preconditions to Arbitration and Consent of States to ICSID Jurisdiction. In: Kinnear Meg, FISCHER, Geraldine R., et al. *Building International Investment Law: The First 50 Years of ICSID.* Alphen aan den Rijn : Kluwer Law International, 2015. Pp. 219 – 236. P. 235.

[287] MCLACHLAN, Campbell, SHORE, Laurence and WEINIGER, Matthew. *International investment arbitration substantive principles*. Oxford : Oxford University Press, 2017. Para 7.95; similarly, GAZZINI, Tarcisio. The Role of Customary International Law in the Field of Foreign Investment. *The Journal of World Investment & Trade*. 2007, 8(5), pp. 691–715.

[288] ALVAREZ José E. *The public international law regime governing international investment*. The Hague : Hague Academy of International Law, 2011. P. 367 *et seq*.

[289] Statute of the Internationl Court of Justice, 26 June 1945, annexed to the Charter of the United Nations, Article 38.

their hierarchical relationships; however, the general understanding seems to be that such an ordering merely reflects the logical sequence in which the rules would occur to the judge's mind.[290] Hence, according to *Gazzini*, the relationship between IIAs and the custom is rather one of the *lex specialis* and *lex generalis*.[291]

Thus, from the fact that the treaty and customary rules are not hierarchically organized it follows, that the right of the state to regulate is a concept that by no means can be discarded by IIAs as treaty law.[292] Nevertheless, as the maxim *lex specialis derogat legi generali* implies, IIAs being international treaties embody certain limiting element that complements and streamlines the said right, for they place the right to regulate in a specific context where it is necessary to ensure the prudent and legitimate use thereof, given the proprietary rights of investors.

Accordingly, as discussed above regarding the issue of the sovereignty of states, there cannot be seen any deprivation of sovereignty in the conclusion of IIAs, but rather a certain limitation of thereof.

This leads to the conclusion that states are still entitled to regulate their internal affairs, however, those measures must not exceed a certain degree of intervention with the investors' rights, since if they do so the state will bear responsibility for the breach of the IIA in question regardless of whether those measures were adopted in some praiseworthy objective.[293] Otherwise, the investors' protection under IIAs would be essentially debased.

That being said, as the tribunal in *ADC* observed, when the state enters in any international agreement it concurrently undertakes to comply with and fulfil all the obligations stemming

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[290] AKEHURST, Michael. The Hierarchy of the Sources of International Law. *British Yearbook of International Law*. 1976, 47(1), pp. 273–285. P. 274.

[291] GAZZINI, Tarcisio. The Role of Customary International Law in the Field of Foreign Investment. *The Journal of World Investment & Trade*. 2007, 8(5), pp. 691–715. P. 698 – reffering to the cases *ADC,* para 481, *Amoco,* para 112.

[292] *Ibid*., p.697.

[293] See, for example, *Marvin Roy Feldman Karpa v. United Mexican States, ICSID Case No. ARB(AF)/99/1* (also known as Marvin Feldman v. Mexico), Award, 16 December 2002, para. 110; and *Pope & Talbot v Canada*, UNCITRAL, Interim Award, 26 June 2000, Para. 99.

from the said agreement; it cannot later waive those obligations by simply referring to its right to adopt regulations.[294]

2.2 Regulatory vs. Expropriatory measures

Following the foregoing, if considered that the existence of the right to regulate is mostly acknowledged within international investment law, the crux of the matter would then rest in the extent of the lawful exercise thereof.[295]

When in the exercise of their right to regulate the states adopt miscellaneous laws, directives and other measures (relating to many aspects of their existence encompassing taxation, health case, labour and trade law, environmental protection, and many others), it always somehow affects the day-to-day business of all the entities (including foreign investors) residing in the territories of these states.[296] However, the degree of such an impact hugely varies – from a mere aggravation of the investor's operation of its business to a straightforward annihilation thereof. Which in a consequence results in a dichotomy of the state's measures – expropriatory and regulatory. [297]

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[294] *ADC Affiliate Limited and ADC & ADMC Management Limited v The Republic of Hungary, ICSID Case No. ARB/03/16*, Award, 2 October 2006. Para 423

"*It is the Tribunal's understanding of the basic international law principles that while a sovereign State possesses the inherent right to regulate its domestic affairs, the exercise of such right* ***is not unlimited and must have its boundaries.*** *As rightly pointed out by the Claimants, the rule of law, which includes treaty obligations, provides such boundaries. Therefore,* ***when a State enters into a bilateral investment treaty like the one in this case, it becomes bound by it and the investment protection obligations*** *it undertook therein must be* ***honoured rather than be ignored by a later argument of the State's right to regulate*****."**

[295] KOVÁCS, Csaba. Attribution in International Investment Law. *International Arbitration Law Library.* 2018, 45. Kluwer Law International; Kluwer Law International. P. 18.

Técnicas Medioambientales Tecmed, S.A. v The United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para 119;

"*The principle that the State's exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is undisputable.*"

[296] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P. 13.

[297] As the tribunal in *Suez* case observed, *"in evaluating a claim of expropriation it is important to* ***recognize a State's legitimate right to regulate*** *and to exercise its police power in the interests of public welfare and* ***not to confuse measures of that nature with expropriation****."*

Consequently, the tribunals are brought before the question on how to differentiate expropriatory measures of a state, i.e. indirect expropriation, and regulatory measures, i.e. a legitimate exercise of a state's right to regulate.

As was pointed out by the *Tecmed* tribunal, it is crucial for the investment arbitrators when deciding the cases of indirect expropriation

> "*to **distinguish** […] **between a regulatory measure,** which is an ordinary expression of the exercise of the state's police power that entails a decrease in assets or rights, **and a de facto expropriation** that deprives those assets and rights of any real substance*."[298]

Otherwise, if all the state's measures were deemed regulatory, i.e. falling under the right to regulate, investors would not be able to retrieve any compensation for the prospective indirect expropriation which would create a gaping loophole in international investment protection.[299] On the other hand, the distinction of legitimate regulatory measures from expropriation

> "*screens out most potential [disputes] concerning economic intervention by a state and reduces the risk that governments will be subject to claims as they go about their business of managing public affairs*".[300]

Generally, the definitions have concerned the expropriatory measures to be unduly or unreasonably depriving of investors' proprietary rights, while non-compensable regulations were deemed legitimate exercise of the right to regulate of a lesser interference with the investor's ownership.[301]

Suez, Sociedad General de Aguas de Barcelona S.A., and InterAguas Servicios Integrales del Agua S.A. v. The Argentine Republic, Decision on Liability and Separate Opinion of Arbitrator Pedro Nikken, ICSID Case No. ARB/03/17, 30 July 2010, para. 39.

[298] *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 115.

[299] Pope &Talbot, UNCITRAL, Interim Award, 26 June 2000, para. 99; *Saluka Investments B.V. v The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para. 258; *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 121.

[300] *S.D. Myers, Inc. v. Canada*, UNCITRAL, Partial Award, 13 November 2000, para. 282.

[301] *S.D. Myers, Inc. v. Canada*, UNCITRAL, Separate Opinion by Dr. Schwarz (on the Partial Award), 12 November 2000, para. 212.

"***Expropriations tend to deprive the owner […]**. By contrast, regulatory action tends to **prevent an owner from using property in a way that unjustly enriches the owner**. For example, an unregulated manufacturing operation might make more money by not bothering to reduce the amount of pollution it sends into the wider community*."

Additionally, expropriatory measures would usually aim at deprivation of an investor and lead to a corresponding enrichment of the public authority, even though the intention to expropriate and the corresponding enrichment are not requisite elements of indirect expropriation.[302]

On the contrary, non-discriminatory measures, for a public purpose, taken in conformity with due process and in a good faith are deemed to be regulatory. According to *Brownlie's principles* the legitimate exercise of the right to regulate encompasses mainly: "*taxation, trade restrictions involving licenses and quotas, or measures of devaluation, [including the cases where]the state gives a public enterprise special advantages*."[303] Regular exercise of the state's criminal jurisdiction would also primarily fall under regulatory activity which does not amount to expropriation.[304]

But what precisely does the word "legitimate exercise" imply?

The jurisprudence of investment tribunals does not yet provide a clear guidance on what exactly is a legitimate exercise of the state's regulatory activity.[305] In fact, the precise elements of the legitimate exercise of the state's right to regulate are yet to be identified by the means of the investment dispute resolution.[306] However, the tribunals have already provided with certain guidelines on how the legitimacy of the state's regulatory activity shall be assessed.[307] In general, in order to be a legitimate measure, a relation between such measure and the pursued objective has to be found. Some of the tribunals even suggest that not only the measure has to be capable of reaching the objective, but it also must be the least harsh possible.[308] Moreover,

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[302] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. Pp. 13, 15.

[303] CRAWFORD, James. *Brownlie's principles of public international law.* 8th ed. Oxford: Oxford University Press. 2012. P.532.

[304] MOSTAFA, Ben. The Sole Effects Doctrine, Police Powers and Indirect Expropriation under International Law. *Australian International Law Journal*. 2008, 15:267, pp. 267-296. P. 291.

[305] SPEARS, Suzanne A. The Quest for Policy Space in a New Generation of International Investment Agreements. *Journal of International Economic Law* 2010, 13(4), 1037–1075. P. 1058

[306] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P. 156.

[307] For this, see the Chapter 3. of this Part of the thesis.

[308] For further explanation, see the subsection 3.3 below, which provides with the discussion on the proportionality test.

the notion of legitimacy would be usually fulfilled in the cases of regulations in preservation of public health, environment, in the criminal law and taxation measures.[309]

Nevertheless, the question regarding what precisely counts as a legitimate and bona fide regulation which would justify a deprivation of investor's property remains rather thorny.[310]

2.3 Right to regulate vs. the duty to compensate

Getting to the crux of the matter, we gravitate back to the question put forth in the beginning of this Chapter.

Naturally, the main issue concerning the state's right to regulate within the ambit of international investment law is the question of compensation in cases where no appropriation is involved but the investment is aggrieved by the state's regulatory activity.[311] More specifically, the problem lies with a way of approaching adverse impacts such regulatory activity might have on the investments protected under IIAs and, most of all, an exemption of the host state from the duty to pay.[312]

Generally speaking, in international law the states have in principle right of taking of any property.[313] However, as mentioned before, the possibility to lawfully take over the (foreign) property is not unlimited as states can only do so in a non-discriminatory way, for a public purpose, in accordance with due process of law, and on payment of prompt and adequate compensation[314]. The requirement of an adequate compensation is usually referred to as Hull

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[309]NEWCOMBE, Andrew. The Boundaries of Regulatory Expropriation in International Law. *ICSID Review – Foreign Investment Law Journal*. 20 (1), 2005, pp. 1-57. P. 3.

[310] *Ibid*.

[311] MONT, Santiago. *State Liability in Investment Treaty Arbitration; Global Constitutional and Administrative Law in the BIT Generation*. 2012. Oxford and Portland : Hart Publishing. P. 240

[312] BÖRNER Andreas *Simple Truths on the Right to Regulate and the Duty to Pay*. *German Arbitration Journal*. Kluwer Law International; Verlag C.H. Beck oHG. 2017, 15(1), pp. 2 – 11. Pp. 4-5.

[313] SCHREUER, Christoph. The Concept of Expropriation under the ETC and other Investment Protection Treaties. Transnational Dispute Management (TDM) [online]. 1 June 2005, 2.3. [Accessed 20 June 2019]. Available at https://www.transnational-dispute-management.com/article.asp?key=467. P. 2.

[314] See in KADIR, M. Ya'kub Aiyub. Hull Formula and Standard of Compensation for Expropriation in Postcolonial States. *Kanun: Jurnal Ilmu Hukum* [online]. 29 May 2017, 19(2), 231-248, p. 235 [Accessed 20 June 2019]. ISSN 2527 – 8428. Available from http://www.jurnal.unsyiah.ac.id/kanun/article/view/7061/6825; MARBOE, Irmgard. *Calculation of compensation and damages in international investment law*. 2nd ed. Oxford : Oxford University Press, 2012. P.20, paras 2.45-2.46.

formula.[315] However, in cases when the concept of the state's right to regulate is taken into consideration, the application of the Hull formula is considered to be contradicted thereby.[316]

According to *prof. Newcombe* this matter is more about the allocation of risks between the states and investors.[317] On one hand, it is not reasonable to require the investor the bare the cost of the necessary society-wide regulations; on the other, the states cannot be required to buy back each and every regulatory measure they adopt. The states simply would not be able to carry on with their activity *"if to some extent […] property could not be diminished without paying for every […] change in the general law.*"[318]

On that account, *Dr. Titi* concluded that the right to regulate denotes *"the legal right* ***exceptionally permitting*** *the host state* ***to regulate in derogation of international commitments*** *it has undertaken by means of an investment agreement* ***without incurring a duty to compensate***".[319]

A considerable number of scholars and tribunals have also repeatedly established that **"*no right to compensate arises for reasonably necessary regulations*** *passed for the protection of public health, safety, morals or welfare"*.[320] One for all, the tribunal in *Saluka* concluded that

> "*it is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulation that are aimed at the general welfare*".[321]

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[315] DUGAN, Christopher F., WALLACE, Don, RUBINS, Noah and ṢABĀḤĪ, Burzū. *Investor-state arbitration*. New York : Oxford University Press, 2011. P. 438.

[316] PELLET, Alain. *Chapter 32: Police Powers or the State's Right to Regulate*. In: BIDEGAIN Mairée Uran, KINNEAR, Meg N., TORRES, Luisa Fernanda., FISCHER, Geraldine R. and ALMEIDA Jara Mínguez. Building international investment law: the first 50 years of ICSID. Alphen aan den Rijn : Wolters Kluwer, 2016.. P. 449.

[317] NEWCOMBE, Andrew. The Boundaries of Regulatory Expropriation in International Law. *ICSID Review – Foreign Investment Law Journal*. 20 (1), 2005, pp. 1-57. P. 45.

[318] *Pennsylvania Coal Co v Mahon* 260 US 393, at 413 (1922) (Justice Holmes).

[319] TITI, Catharine. *The right to regulate in international investment law*. Baden-Baden : Nomos, 2014. P. 52.

[320] NEWCOMBE, Andrew. The Boundaries of Regulatory Expropriation in International Law. *ICSID Review – Foreign Investment Law Journal*. 20 (1), 2005, pp. 1-57. P. 23; *S.D. Myers, Inc. v. Canada, UNCITRAL*, Partial Award, 13 November 2000, para. 281; *Lauder v. Czech Republic*, UNCITRAL, IIC 205 (2001), Final Award, 3 September 2001, para. 198; *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 119.

[321] *Saluka Investments B.V. v The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para. 255.

Hence, although the state's regulatory measures adopted in order to preserve public welfare, order or safety can often be experienced as detrimental, and hence mistaken for an indirect expropriation by the affected investors, those measures will typically not give rise to compensation.[322] However, these measures have to fulfil the aforediscussed requirement of legitimacy in order to amount to "*regulator expropriation*" which does not trigger the duty to compensate as does indirect expropriation.[323]

For the sake of completeness, it is important to mention that, for example, the tribunal in *Santa Elena case* dismissed the notion of non-compensatory regulations stating that

> "*While an expropriation or taking for environmental reasons may be classified as a taking for a public purpose, and thus may be legitimate,* ***the fact that the Property was taken for this reason does not affect either the nature or the measure of the compensation to be paid*** *for the taking. That is, the purpose of protecting the environment for which the Property was taken does not alter the legal character of the taking for which adequate compensation must be paid. The international source of the obligation to protect the environment makes no difference*."

The same stance was adopted with regard to the taxation measure in *Burlington* and to the licence measure in *Tecmed* where measures normally falling under the legitimate right to regulate, and therefore excluded from the ambit of expropriation, nevertheless were found to not exempt the states from their duty to compensate.[324]

Consequently, it follows that in cases where the state adopts a regulation in pursuance of its legitimate policy it would more often than not be exempted from the duty to compensate the aggrieved investor. However, the consideration must be given to the gravity of an impact the measure has on the said investor's business.

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[322] UNCTAD II, p. 21.

[323] The term "regulatory expropriation" is often used to the contrary of indirect expropriation when referring to the regulatory activity of states; see, for example, PAPARINSKIS, Martins. Chapter 13: *Regulatory Expropriation and Sustainable Development*. In: SEGGER, Marie-Claire, GEHRING, Markus W. and NEWCOMBE, Andrew. *Sustainable development in world investment law*. Alphen aan den Rijn : Kluwer Law International, 2011, pp. 299 – 327. Pp.299 – 327; NEWCOMBE, Andrew. The Boundaries of Regulatory Expropriation in International Law. *ICSID Review – Foreign Investment Law Journal*. 20 (1), 2005, pp. 1-57.

[324] BURGHETTO, María, Beatriz and LORFING, Pascale, Accaoui. The Evolution and Current Status of the Concept of Indirect Expropriation in Investment Arbitration and Investment Treaties. *Indian Journal of Arbitration Law*. 2017, VI (2), pp. 98 -123. P. 115

3. FINDING THE LINE BETWEEN REGULATORY AND EXPROPRIATORY

Not only the doctrine based on the dichotomy of the state's measures that appeared because of recognition of the non-compensable (regulatory) and compensable (expropriatory) measures had necessitated certain progress regarding the delineation thereof. Over the last few decades, the investment tribunals have encountered quite a number of cases where the conflict between regulatory deeds of a state and the concept of indirect expropriation had to be dealt with.[325]

Unlike the cases of direct expropriation mentioned in the Section 1.1 *et seq.* of the Part "Expropriation", states would usually refuse to acknowledge the expropriatory nature of the adopted measures and would not offer compensation to the aggrieved investor trying to justify its deeds by the concept of the state's right to regulate.[326] Thus, the only option left for the injured investor is to seek protection under the IIA in question and bring a claim before an international investment tribunal.

Hence, same as doctrine, the practice of the investment tribunals is in a disarray as regards establishing the line between legitimate regulatory measures and forms of indirect or creeping expropriation.[327] The reason why neither the doctrine nor the ISDS practice has yet been able to satisfactorily resolve this matter is simple – the issue is very complex with many variables to take into consideration when searching for the compromise between public and private rights and interests. Moreover, it is necessary to take into account the social and political context of the respective measures when determining whether an indirect expropriation has occurred.[328]

Therefore, there still has not been elaborated any mechanical formula or test that would fit every case where the tribunal must find whether the adopted state measures have breached

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[325] *Advanced Search | Investment Dispute Settlement Navigator | UNCTAD Investment Policy Hub* [online]. [Accessed 20 June 2019]. Available at https://investmentpolicy.unctad.org/investment-dispute-settlement/advanced-search.

[326] UNCTAD II, p. 12.

[327] CRAWFORD, James. *Brownlie's principles of public international law.* 8th ed. Oxford: Oxford University Press. 2012. P. 622.

[328] BÜCHELER, Gebhard. Proportionality in investor-state arbitration. 1st ed. Oxford, United Kingdom : Oxford University Press, 2015. P.125-126.

the dividing line between legitimate and expropriatory.[329] Additionally, due to the fact that the cases usually cover many different backgrounds and issues relating to the expropriation claim, the decision-making process usually necessitates a well elaborated case-by-case approach. As was also pointed out by the tribunal in the *Feldman* case, every dispute based on the alleged indirect expropriation has to be assessed in light of all the circumstances.[330]

In consequence, the determination of each and every challenged measure falls to the adjudicator which has to decide whether such measure was legitimate or whether the state has crossed the line.[331]

Finally, it bears mentioning that this deliberation is more necessary in cases where the state's right to regulate is recognized. Where the tribunals applied the effects test, purpose and nature of measures forfeited its relevance.

In the following, this Chapter will address the three main approaches of the investment tribunals to the establishment of cases of indirect expropriation and the relationship thereof towards the concept of the right to regulate.

These approaches can be described as an effect approach, an except approach and a balance approach.[332] The first two mentioned are represented by the sole effects doctrine and the police powers doctrine which are usually described as two leading tests applied by the

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[329] PAULSSON, Jan, DOUGLAS, Zachary. *Indirect expropriation in investment treaty arbitration*. In: HORN, Norbert, KRÖLL, Stefan. *Arbitrating Foreign Investment Disputes*. Alphen aan den Rijn : Wolters Kluwer, 2004. P. 145;

See also *Saluka*

"*international law has yet to draw a bright and easily distinguishable line between non-compensable regulations on the one hand and, on the other, measures that have the effect of depriving foreign investors of their investment" Saluka Investments B.V. v The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para. 263.

[330] *Marvin Roy Feldman Karpa v. United Mexican States, ICSID Case No. ARB(AF)/99/1* (also known as Marvin Feldman v. Mexico), Award, 16 December 2002, para. 106.

[331] *Saluka Investments B.V. v The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para. 264.

"*Faced with the question of when, how and at what point an otherwise valid regulation becomes, in fact and effect, an unlawful expropriation, international tribunals must consider the circumstances in which the question arises. The context within which an impugned measure is adopted and applied is critical to the determination of its validity.*";

Pope & Talbot v Canada, UNCITRAL, Interim Award, 26 June 2000, para 99.

[332] SHIRLOW, Esmé. Deference and Indirect Expropriation Analysis in International Investment Law: Observations on Current Approaches and Frameworks for Future Analysis. *ICSID Review*. 2014, 29 (3), pp. 595–626. P. 5.

investment tribunals in the cases of indirect takings. Lastly, the third approach is considerably novel in the international investment jurisprudence; often referred to as the proportionality test.

3.1 Sole effects doctrine

The tribunals and scholars commonly concluded that impact of adopted measures has to fulfil certain degree of gravity in order to be perceived as expropriatory. Followingly, in ISDS practice severity of such impact or interference with investor's property became a cardinal aspect in the assessment of state's measures through the prism of indirect expropriation.[333] Some of the arbitrators, however, did not go past this criterion basing the assessment of state's measures solely on the effect thereof on investor's property.[334] This approach is commonly referred to as the "sole effects doctrine".

The concept of the sole effects doctrine is deemed to stem from the practice of the Iran-US Claims Tribunal. [335] It is important to emphasize that this doctrine is merely a construct of scholarly writings and practice of the investment tribunals and not a norm of customary law even though, for example, the tribunal in *Metalclad* came to this conclusion.[336]

The sole effects doctrine approach focuses solely on the particular effect a regulation or a measure has on investor's proprietary rights making it the sole determinative criterion.[337] The purpose for adoption of regulatory measures is of no significance making the differentiation between legitimate and expropriatory regulations redundant as, in the end, all actions with

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[333] DOLZER, Rudolf a Felix BLOCH. Indirect Expropriation: Conceptual Realignments? *International Law FORUM du droit international*. 2003, 5(3), pp. 155–165. P. 164.

[334] Cases referring to the sole eff are for example *Tokios Tokelés v Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, 29 April 2004, para. 120; *Sempra Energy International v The Argentine Republic*, ICSID Case No. ARB/02/16, Award, 28 September 2007, para. 285.

[335] MOSTAFA, Ben. The Sole Effects Doctrine, Police Powers and Indirect Expropriation under International Law. *Australian International Law Journal*. 2008, 15:267, pp. 267-296. P. 280; SCHREUER, Christoph. The Concept of Expropriation under the ETC and other Investment Protection Treaties. Transnational Dispute Management (TDM) [online]. 1 June 2005, 2.3. [Accessed 20 June 2019]. Available at https://www.transnational-dispute-management.com/article.asp?key=467. P. 37, para. 113; for the issues related to the application of the Iran-Us case law in the practice of the investment tribunals, see the Chapter 2. in the Part "Indirect Expropriation".

[336] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P. 151.

Metalclad Corporation v The United Mexican States, ICSID Case No. ARB (AB)/97/1, Award, 30 August 2000, para. 103.

[337] DOLZER, Rudolf and BLOCH, Felix. Indirect Expropriation: Conceptual Realignments? *International Law FORUM du droit international*. 2003, 5(3), pp. 155–165. P. 158.

certain degree of impact would inevitably amount to indirect expropriation.[338] Therefore, unlike the police powers doctrine which is based on finding of non-violation of the expropriation standard, the sole effect doctrine seeks indications of violation.[339]

Given the fact that plentiful awards based on the sole effects doctrine were delivered by the Iran-US Claims Tribunal, it bears noting conclusion of some of the most iconic ones; yet it is necessary to reiterate beforehand that the application of this tribunal's decisions in the ambit of investment cases has its limits.[340]

Both the *Tippetts* and the *Starrett Housing* case strongly sided with the sole effects doctrine.[341] These cases coincidently referred to the effect of measures adopted by state and held that when the effect is severe enough (i.e. the investor is virtually ripped off of all of its ownership components) no regard should be given to intent of a state to expropriate.

One of the most illustrative cases where the investment tribunal applied the sole effects doctrine is a NAFTA case *Metalclad.* In this case a company Metalclad obtained a permit to build and operate a hazardous waste landfill in Mexico. Metalclad alleged Mexican government from (i) adopting measures which eventually virtually prevented the company from operating its facility and (ii) adopting the Ecological Decree creating an ecological preserve at the place of a landfill which had an effect of barring the operation thereof.[342]

The *Metalclad* tribunal dealt with issues of expropriation in a rather brief and simplified way. It found that the measures effectively and unlawfully led to prevention from operating the landfill by Metalclad, and thus, amounted to indirect expropriation.[343] The tribunal categorically refused to take Mexican government's intentions into consideration expressly stating that "*the [Ecological] Decree had the* ***effect of barring*** *forever the operation of the*

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[338] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P.150.

[339] TITI, Catharine. *The right to regulate in international investment law*. Baden-Baden : Nomos, 2014. P. 281, 282.

[340] For further discussion please see the Chapter 2. in the Part "Indirect Expropriation".

[341] *Iran-US Claims Tribunal Starrett Housing Corp. v. Iran*, 16 IRAN-U.S. C.T.R., Interlocutory Award, 19 December 1983, para 122; and *Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA*, 6 IRAN-U.S. C.T.R., Award, 28 October 1985, para. 219.

[342] *Metalclad Corporation v The United Mexican States*, ICSID Case No. ARB (AB)/97/1, Award, 30 August 2000, para. 109.

[343] *Ibid.*, paras. 106-7.

landfill" which serves as a ground for finding an expropriation and therefore the tribunal "*[does not need to] decide or consider the motivation or intent of the adoption of the Ecological Decree*."[344] Interestingly, besides the case of *Biloune* which the tribunal considered as a persuasive authority, no other authorities or sources in support of the above cited conclusions were referred to.[345]

Among the cases siding with the sole effects doctrine can be also listed *Santa Elena* case.[346] Although in this case the tribunal acknowledged the existence of a legitimate exercise of the state's regulatory powers for a public purpose, it also concluded that this could not exempt the state from its liability to compensate if such a regulation has an effect of taking.[347] Additionally, it is necessary to stress that in this particular case both parties agreed on the fact that expropriation took place and therefore, the tribunal did not have to elaborate excessively on this matter.[348] Nevertheless, this tribunal by all means chose a very strict interpretation of investment law as teleologically oriented towards the protection of proprietary rights.[349]

Similarly was concluded by the tribunal in *Patrick Mitchell Annulment* which stated that the fact that the arbitral tribunal which issued the award "*focused **solely on the impact** that the measure had on the 'investment' **corresponds to the application of the tantamount principle** which is consistent with the spirit of investment treaties, **namely the protection of investors**.*"[350]

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[344] *Ibid*., para. 109.

[345] *Ibid.,* para. 108.

[346] BENEDETTO, Saverio Di. International investment law and the environment. Cheltenham : Edward Elgar Publishing, 2014. P.138

[347] *Compañia del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award, 17 February 2000, para. 71;

"*While an expropriation or taking for environmental reasons may **be classified as a taking for a public purpose**, and thus may be **legitimate**, the fact that the property was taken for this reason **does not affect either the nature or the measure of the compensation to be paid for the taking**. That is, the purpose of protecting the environment for which the Property was taken does not alter the legal character of the taking for which adequate compensation must be paid. The international source of the obligation to protect the environment makes no difference.*"

[348] *Compañia del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award, 17 February 2000, para. 35.

[349] BENEDETTO, Saverio Di. International investment law and the environment. Cheltenham : Edward Elgar Publishing, 2014. P.138.

[350]. *Mr. Patrick Mitchell v. Democratic Republic of the Congo*, ICSID Case No. ARB/99/7, Decision on the Application for Annulment of the Award, 1 November 2006, para. 53.

The annulment tribunal substantiated its conclusions by referring to the 1992 Directives of the World Bank and, most of all, the *Metalclad* decision, stating that referring solely to the effects of the measures on the aggrieved investor regardless the purpose thereof "*appears to be a practice of arbitrators – at present a majority of them – in international investment disputes when they are assessing the tantamount character [to expropriation]*."[351]

Additionally, for example in *El Paso* was also applied the "effect" approach on the grounds of which the tribunal refused to hold the occurrence of expropriation due to the lack of interference with El Paso's property.[352]

Interestingly, the *Telenor* tribunal has expressly acknowledged the existence of the police powers doctrine; nevertheless, it then proceeded with application of the sole effects doctrine.[353]

Lastly, it bears mentioning *Tecmed*; a significant case supporting the line weighting solely the effect of state's measure while deciding on occurrence of indirect expropriation. In this case the tribunal dealt with non-renewal of licences which were requisite for the investor's operation of its business – a landfill of hazardous waste.[354]

The reasoning of the *Tecmed* tribunal is germane for two reasons. Firstly, even though this tribunal has resorted to application of the sole effects doctrine, it has also deliberated on the application of the proportionality test, which makes it the first tribunal to employ the such test in the frames of investment arbitration.[355] Secondly, this tribunal has also acknowledged that the police powers doctrine exists and that measures falling therein do not have to be compensated. However, it also added, that this applies solely within the ambit of domestic laws and cannot be employed by an international tribunal.[356]

Some of the scholars have supported this doctrine considering it as the only logical approach to the assessment of regulatory activity of states in relation to indirect expropriation.

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[351] *Ibid*.

[352] *El Paso Energy International Company v The Argentine Republic*, ICSID Case No. ARB/03/15, Award, 31 October 2011, paras. 278-280.

[353] *Telenor Mobile Communications A.S. v Republic of Hungary*, ICSID Case No. ARB/04/15, Award, 13 September 2006, para. 70.

[354] *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, paras. 35-42.

[355] *Ibid.*, paras. 116 – 122; ANON., 2019. Iisd.org [online] [accessed. 3 . December 2019]. Available at https://www.iisd.org/sites/default/files/publications/int_investment_law_and_sd_key_cases_2010.pdf.

[356] *Ibid.,* para. 119.

The reason for such a view resides primarily in the argument that the regulatory measures falling squarely into the exercise of the state's right to regulate have to comprise solely of measures that do not exorbitantly interfere with foreign investment or deprive investors of their proprietary rights.[357] Additionally, a high threshold which state's measures have to reach in order to be deemed expropriatory is considered sufficient to also protect state's regulatory interests. According to *Mostafa* the threshold under the sole effects doctrine requires a *"very high level of interference with property"* which means that majority of regulations would be unable to amount to expropriation.[358]

Assessing the foregoing, on one hand, the argumentation for the use of the sole effects doctrine is quite persuasive and fairly understandable. The sole effects doctrine is essentially based on the assumption that the lawful expropriation can occur only if the measure is non-discriminatory, adopted in accordance with due process in public interest, and adequately compensated. Which means that any measure the effect of which amounts to expropriation would become unlawful if one of the foregoing conditions was not met. The problem is that not only this approach is too formal and mechanical, but it is also fairly outdated in relation to more recent (speaking about the timeframe of last twenty years) wordings of the expropriation clauses incorporated in IIAs (even without reservations or GECs).[359]

Thus, several scholars sided with the opposite view which criticizes insufficiency of a sole effects doctrine approach.[360] One of the main problems is the questionable origin of this doctrine which itself is far from flawless.[361] In fact, the "operation" of the Iran US Claims Tribunal is based on a very different set of rules which impose divergent criteria for

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[357] FORTIER, L. Y. and DRYMER, S. L. Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor. *ICSID Review*. January 2004. Vol. 19, no. 2p. 293–327. P. 308.

[358] MOSTAFA, Ben. The Sole Effects Doctrine, Police Powers and Indirect Expropriation under International Law. *Australian International Law Journal*. 2008, 15:267, pp. 267-296. P. 288

[359] See, for example, Moldova, Republic of - United Arab Emirates BIT (2017), Article 12; Burundi - Turkey BIT (2017), Article 5; Mauritius-Pakistan (1997), Article 12.

[360] PELLET, Alain. *Chapter 32: Police Powers or the State's Right to Regulate*. In: BIDEGAIN Mairée Uran, KINNEAR, Meg N., TORRES, Luisa Fernanda., FISCHER, Geraldine R. and ALMEIDA Jara Mínguez. Building international investment law: the first 50 years of ICSID. Alphen aan den Rijn : Wolters Kluwer, 2016. P. 458.

[361] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P. 72.

expropriatory measures.[362] Moreover, such a one-sided approach leaves no space for recalibration of the competing rights which is needed in the economy of the current world which is highly concerned with environmental impacts of the industry.

Another drawback of the sole effects doctrine is lurking in its very core – this doctrine requires exclusively certain effect inflicted by the adopted measures on the investment. However, as also follows from the previous Part of this thesis, it is very difficult to establish the line which would demarcate the perfect "amount" of severity of the impact which would always amount to expropriation.[363]

Hence, even though some of the scholars strongly side with and support this doctrine, it still "*remains a highly controversial approach to indirect expropriation*".[364] According to *prof. Herdegen*, the controversies currently lie with the dilemma "*whether qualification of an action as indirect expropriation or measure tantamount to expropriation* ***should only consider the adverse effect of a State measure on the investment ('sole effects doctrine') or also the aim and interests pursued by the host State***."[365]

Finally, the sole effects doctrine has without any doubt been so far leading approach to assessment of indirect expropriation cases. Nevertheless, in consideration of inherent flaws that coalesce this doctrine the investment tribunals started to shift to the scrutiny of the challenged measures under the doctrine of police powers.[366]

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[362] IRAN-UNITED STATES CLAIMS TRIBUNAL, TRIBUNAL RULES OF PROCEDURE 3 May 1983, Article 18 states: "*expropriations or* ***other measures affecting property rights.***"

RAJPUT, Aniruddha. Problems with the Jurisprudence of the Iran–US Claims Tribunal on Indirect Expropriation. *ICSID Review*. 2015, 30(3), pp. 589–615. P. 593.

[363] DOLZER, Rudolf. Indirect expropriations: new developments. *New York University Environmental Law Journal*. 2002, 11(1), 64-93. P. 79-80. CHOUKROUNE Leïla. *Judging the State in International Trade and Investment Law Sovereignty Modern, the Law and the Economics*. Puchong, Selangor D.E. : Springer Singapore, 2018. P. 132.

[364] MCLACHLAN, Campbell, SHORE, Laurence and WEINIGER, Matthew. *International investment arbitration substantive principles*. Oxford : Oxford University Press, 2017. P.388, para. 8.88.

[365] HERDEGEN, Mathias. *Principles of International Economic Law*. 2nd ed. Oxford : Oxford University Press, 2016. P. 472.

[366] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P. 66.

3.2 Police powers doctrine

There is a considerably significant number of awards where the tribunals recognized the existence of the state's right to regulate as a norm under which the state is not responsible for the negative economic effects its regulatory activities have on the investors' proprietary rights.[367] This body of case law implies that not only the effect of the measure but also its purpose is a substantial factor when assessing the cases of prospective indirect expropriation.

As regards the roots of the police powers doctrine, it stems from the US constitutional law where it was firstly introduced in the case *Brown v. Maryland*.[368] It was then fairly frequently applied within the arbitral practice of the investment tribunals. Notwithstanding, neither this doctrine has been so far applied unequivocally and uniformly by the investment tribunals, leaving us with several unresolved issues connected thereto.

In the present day, according to *prof. Viñuales* the police powers doctrine "*exists as a matter of customary international law"* while its "*actionable character [is deemed] an expression of sovereignty".*[369] Hence, the notion of the police powers doctrine represents "*an attempt by investment tribunals to reconcile the sovereign right of the State, as the guardian of the general public interest, to regulate economic activities on its territory with its treaty or contractual obligations*."[370]

Followingly, unlike the sole effects doctrine, this approach to the assessment of the state's activity in the cases of the alleged indirect expropriation, which is referred to as the police powers doctrine, is not limited by the one-dimensional point of view, i.e. the sight of the effect of the measure. On the contrary, the police powers doctrine not only acknowledges the existence of the state's inherent right to regulate its internal matters, but also adds this "variable" into the equation of indirect expropriation case assessment.

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[367] Ibid.; for example, *Feldman*, *Saluka*, *Methanex*, etc.

[368] LEGGARE, Santiago. The Historical Background Of The Police Power. *Journal of Constitutional Law.* 2002, 9(3), 745-796. P. 747.

[369] DOUGLAS, Zachary, PAUWELYN, Joost, and VIÑUALES, Jorge E. *The Foundations of International Investment Law: Bringing Theory Into Practice*. Oxford, United Kingdom : Oxford University Press, 2014. P. 329.

[370] PELLET, Alain. *Chapter 32: Police Powers or the State's Right to Regulate*. In: BIDEGAIN Mairée Uran, KINNEAR, Meg N., TORRES, Luisa Fernanda., FISCHER, Geraldine R. and ALMEIDA Jara Mínguez. Building international investment law: the first 50 years of ICSID. Alphen aan den Rijn : Wolters Kluwer, 2016. P. 447.

The logic behind this approach is very well traceable. Primarily, the investor simply cannot rely on the stillness and eternal unchangeability of the host state's legal framework or that its activity will not be subjected to the host state's regulations.[371] Hence, not all of the economic difficulties the investor would experience due to the regulatory changes should be treated as indirect expropriation.[372] The latter was concluded for example by the tribunal in the NAFTA case *Feldman* which, following the decision in *Azurix*[373] case, stated that:

> "***not all government regulatory activity that makes it difficult or impossible*** *for an investor to carry out a particular business, change in the law or change in the application of existing laws that makes it uneconomical to continue a particular business,* ***is an expropriation under Article 1110****. Governments,* ***in their exercise of regulatory power****, frequently change their laws and regulations in response to changing economic*

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[371] PUPOLIZIO, Ivan. The Right to an Unchanging World. Indirect Expropriation in International Investment Agreements and State Sovereignty. *SSRN Electronic Journal*. 2015. P. 4 *et seq*.

Further, see, for example, *Telenor*:

"*the* ***mere exercise by government of regulatory powers that create impediments to business or entail the payment of taxes or other levies does not of itself constitute expropriation.*** *Any investor entering into a concession agreement must be aware that investment involves risks and that in some degree the investor's activities are likely to be regulated and payments made for which the investor will not receive compensating advantages. These are all part of the price the investor has to pay for securing the concession. Similarly, unreasonable behaviour on the part, of officials and breaches of contract, even if serious, do not by themselves constitute acts of expropriation. The conduct complained of must be such as to have a major adverse impact on the economic value of the investment*."

Telenor Mobile Communications A.S. v Republic of Hungary, ICSID Case No. ARB/04/15, Award, 13 September 2006, para 64.

[372] CRAWFORD, James. *Brownlie's principles of public international law.* 8th ed. Oxford: Oxford University Press. 2012. P. 621;

"*State* ***measures, prima facie lawful, may affect foreign interests considerably without amounting to expropriation****. Thus, foreign assets and their use may be subjected to taxation, trade restrictions such as quotas, revocation of licences for breach of regulations, or measures of devaluation. While special facts may alter cases, in principle such measures are not unlawful and do not constitute expropriation. If the state gives a public enterprise special advantages, for example by directing that it charges nominal rates of freight, the resulting de facto or quasi-monopoly is not an expropriation of the competitors driven out of business: but it might be otherwise if this were the object of a monopoly regime. Taxation which has the precise object and effect of confiscation is unlawful but high rates of tax, levied on a non-discriminatory basis, are not. In general, there is no expectation that tax rates will not change: a foreign investor must obtain a clear commitment to that effect, for example, in a stabilization agreement*."

[373] *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12.

circumstances or changing political, economic or social considerations. Those changes may well make certain activities less profitable or even uneconomic to continue."[374]

It is also worth mentioning the tribunal's view in an ICSID case *Tecmed* which acknowledged the fact that

"*[t]he principle that* ***the State's exercise of its sovereign powers*** *within the framework of* ***its police power*** *may cause economic damage to those subject to its powers as administrator* ***without entitling them to any compensation*** *whatsoever is undisputable."*[375]

However, as referred to earlier, in this particular case the tribunal subsumed the assessment of the reasons for particular legislative acts or the state's police powers under the framework of the domestic law stating that it had no foundation to "*review the grounds or motives of the [legal act] in order to determine whether it could be or was legally issued.*"[376]

Considering the application of the police powers doctrine within the arbitral practice, the very scope thereof was interpreted in two ways – broader and narrower. As a matter of fact, it is commonly acknowledged that there is a certain magnitude within the application of the police powers doctrine in the practice of investment tribunals.[377]

Thus, based on the significance the tribunal gives to the purpose of the state's measures, two variations of the police powers doctrine can be noticed; the radical or stringent and the moderate or mitigated approach.[378]

Rather stringent was the decision in the *Saluka* case where Saluka asserted that it was deprived of its investment due to the reorganization and privatization of the Czech banking sector.[379] The tribunal first recognized the state's power to regulate by observing that

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[374] *Marvin Roy Feldman Karpa v. United Mexican States, ICSID Case No. ARB(AF)/99/1* (also known as Marvin Feldman v. Mexico), Award, 16 December 2002, para. 112.

[375] *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para 119.

[376] *Ibid*., paras. 119 – 120.

[377] LEONHARDSEN, Erlend M. Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration. *SSRN Electronic Journal*. 2011. P. 30.

[378] BÜCHELER, Gebhard. Proportionality in investor-state arbitration. 1st ed. Oxford, United Kingdom : Oxford University Press, 2015. P. 128-129; *Ibid*.

[379] *Saluka Investments B.V. v The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para. 1, 26.

"[*i*]*t is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulation that are aimed at the general welfare.*"

Followingly, upon the assessment of all the facts of the case, the tribunal acknowledged that the Czech Republic's measures of imposing the forced administration of Saluka indeed "*had the effect of eviscerating Saluka's investment."*[380] Notwithstanding, the tribunal held that "*the Claimant has failed to establish a deprivation of sufficient magnitude to form the basis of an expropriation claim*."[381]

A similar conclusion was reached by the tribunal in the *Methanex* case. The *Methanex* tribunal, as did the tribunal in the *Metalclad* case, has dealt with the connotation of the meaning and scope of measures "tantamount to" expropriation while it has also addressed the question whether regulatory measures that have a significant impact on the investor's business are covered by the concept of indirect expropriations.[382] Contrary to the *Metalclad* case, however, this tribunal sided with the police powers doctrine concluding that:

"*as a* ***matter of general international law, a non-discriminatory regulation for a public purpose****, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment* ***is not deemed expropriatory and compensable unless specific commitments had been given*** *by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation*."[383]

Lastly, another decision which is known for its very radical conclusions regarding application of the police powers doctrine was issues by the *Chemtura* tribunal. [384]

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[380] *Ibid*., para 276.

[381] *Ibid*., para. 277.

[382] ANON., 2019. Methanex v. United States – Investment Treaty News. Iisd.org [online] [accessed. 3 . December 2019]. Available at: https://iisd.org/itn/2018/10/18/methanex-v-united-states/.

[383] *Methanex Corporation v. United States of America,* UNCITRAL, Final Award, 3 August 2005. PART IV CHAPTER D PARA 7.

[384] *Chapter 32: Police Powers or the State's Right to Regulate*. In: BIDEGAIN Mairée Uran, KINNEAR, Meg N., TORRES, Luisa Fernanda., FISCHER, Geraldine R. and ALMEIDA Jara Mínguez. Building international investment law: the first 50 years of ICSID. Alphen aan den Rijn : Wolters Kluwer, 2016. P. 455.

In this case, the claim has arisen from the fact that Canada has taken several steps throughout the years to restrict the use of lindane, an agricultural pesticide.[385] The Claimant, a firm manufacturing lindane, challenged these measures asserting that its investment was deprived by them and thus expropriated.

The tribunal applied the police powers doctrine in its full terms and held that:

"*Even if the Tribunal concluded that there was a substantial deprivation of the Claimant's investment, there was still no expropriation because the PMRA's decision to phase out all agricultural applications of lindane* ***was a valid exercise of Canada's police powers*** *to protect public health and the environment. The decision of the PMRA to de-register lindane meets the test of this doctrine because (i)* ***it was not made in an arbitrary manner*** *since it respected due process and was based on valid science; (ii)* ***it was non-discriminatory****; (iii) it was* ***not excessive****; and (iv) it* ***was made in good faith*** *to combat the serious occupational exposure risks posed by lindane*."[386]

The tribunal also further explained that adoption of the said measures was "*motivated by the increasing awareness of the dangers presented by lindane for human health and the environment [and that a] measure adopted under such circumstances is a valid exercise of the State's police powers and, as a result, does not constitute an expropriation*."[387]

Following these decisions, no wonder that such an application of the police powers doctrine has also earned its deal of criticism.[388] As a matter of fact, a strong reliance on the purpose of the state's measures could have the effect of excluding all the regulatory measures of the state from the concept of indirect expropriation leaving it emptied.[389] The rule of a thumb is, that measures in order to be legitimate exercise of the state's right to regulate, most of all, have to be in the public purpose. However, the tribunals have little to no discretion in this

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[385] *Chemtura Corporation v. Government of Canada*, UNCITRAL, Award, 2 August 2010, para. 8.

[386] *Ibid.*, para. 254.

[387] *Ibid*., para. 266.

[388] BÜCHELER, Gebhard. Proportionality in investor-state arbitration. 1st ed. Oxford, United Kingdom : Oxford University Press, 2015. P. 128; LEONHARDSEN, Erlend M. Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration. *SSRN Electronic Journal*. 2011. P. 30.

[389] Thus, as stated in the *Pope & Talbot* case "*a blanket exception for regulatory measures would create a gaping loophole in international protection against expropriation*."

Pope & Talbot v Canada, UNCITRAL, Interim Award, 26 June 2000, Para. 99.

context as in the current "*state of customary international law [and] in the field of foreign investment, is that states are free to determine what is in their public interest*".[390]

Hence, the investment tribunals started to opt for a more balanced approach when assessing the state's right to regulate its internal matters which lead to the formation of the moderate approach.[391] Under this approach the tribunals are more drawn to distinguish the regulatory and expropriatory measures of the state.

In this context, the *Feldman* case tribunal upheld the state's right to regulate upon assessing application of certain tax laws by Mexico to the export of tobacco products by the Claimant.[392] The tribunal stressed the necessity of the state's freedom to regulate in a broader public interest in pursuance of the protection of the environment and other similarly important objectives.[393] However, it also dismissed the argumentation of Mexico, the Respondent, that any measure adopted in public purpose will not amount to expropriation. Concerning this, the tribunal held that "*no one can seriously question that in some circumstances government regulatory activity can be a violation of Article 1110 (expropriation)*" and that, referring to the *Pope & Talbot* decision "*regulations can indeed be characterized in a way that would constitute creeping expropriation.*"[394]

It is important to reiterate that the tax measures are usually more easily recognized as a legitimate activity of a state and thus, in order for this activity to be deemed expropriatory, the investment would have to be virtually annihilated with the traceable discriminatory intent of

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[390] VINUALES, J.e. Sovereignty in Foreign Investment Law. In: DOUGLAS, Zachary, PAUWELYN, Joost, and VIÑUALES, Jorge E. *The Foundations of International Investment Law: Bringing Theory Into Practice*. Oxford, United Kingdom : Oxford University Press, 2014, pp. 317–362. P. 278.

[391] LEONHARDSEN, Erlend M. Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration. *SSRN Electronic Journal*. 2011. P. 30.

[392] ANON., 2019. Biicl.org [online] [accessed. 3 . December 2019]. Retrieved z: https://www.biicl.org/files/3924_2002_feldman_v_mexico.pdf.

[393] *Marvin Roy Feldman Karpa v. United Mexican States, ICSID Case No. ARB(AF)/99/1* (also known as Marvin Feldman v. Mexico), Award, 16 December 2002, para. 103.

"*governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this*."

[394] *Marvin Roy Feldman Karpa v. United Mexican States, ICSID Case No. ARB(AF)/99/1* (also known as Marvin Feldman v. Mexico), Award, 16 December 2002, para. 110.

the state. hence, in recognition of the state's right to regulate the tribunal has concluded that the "*state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory[…].*"

Lastly, the tribunal in *El Paso* has also sided with the police powers doctrine.[395] Nevertheless, it also has expressly voiced the need for reasonableness and proportionality in the application of the police powers doctrine.[396]

Followingly, it seems that the practice of the investment tribunals has slightly been shifting towards a more balanced approach even though this doctrine is still not flawless.[397] In fact, as was mentioned by *prof. Lowe*, such a development is not a mere "*accidental result*" of the investment tribunals' creativity in their decision-making process, but rather "*an essential element of the permanent sovereignty of each State over its economy.*"[398]

3.3 The proportionality test

Though the police powers doctrine might seem as a perfectly functional solution, there are still some issues leading the tribunals and scholars to further seek a more nuanced approach to the matter.[399] As was fittingly observed by the tribunal in *Pope & Talbot*, relying solely on the police powers doctrine would provide for "*[a] blanket exception for regulatory measures*

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[395] *El Paso Energy International Company v The Argentine Republic*, ICSID Case No. ARB/03/15, Award, 31 October 2011, para 236

"*the most appropriate approach is to admit that, as a matter of principle**, a general regulation – whose object is not the taking of property as in the case of direct expropriation – does not amount to an indirect expropriation** (a). This evident proposition finds support in State practice, doctrine and arbitral case-law.*"

[396] *Ibid*., para. 241.

"*If general regulations are unreasonable, i.e. arbitrary, discriminatory, disproportionate or otherwise unfair, they can, however, be considered as amounting to indirect expropriation if they result in a neutralisation of the foreign investor's property rights.*"

[397] HERDEGEN, Mathias. *Principles of International Economic Law*. 2nd ed. Oxford : Oxford University Press, 2016. P. 472; "*There is a strong **tendency to focus on the balance** between the inference with the investment and the public interest in terms of proportionality*."

[398] LOWE, Vaughan. Regulation or Expropriation?. *Current Legal Problems*. 2002, 55(1), 447–466. P.450.

[399] DERAINS, Yves and SICARD-MIRABAL. Josefa, Chapter 5: Expropriation. In: *Introduction to Investor-State Arbitration*. Alphen aan den Rijn : Wolters Kluwer, 2018, pp. 115 – 132. P. 127.

[which] would create a gaping loophole in international protections against expropriation."[400] Strictly speaking, blind application of the police powers doctrine would provide a cart blanche for any of the host state's regulations which would render the investors' protection virtually useless.

One of the possible ways to resolve some of the police powers doctrine's drawbacks is to apply the proportionality test. This test has been introduced in the practice of international investment tribunals rather recently and its applicability within the ISDS practice has not been fully determined yet.[401] Some of the scholars see the proportionality test as a complementary tool to be used jointly with the police powers doctrine or any other doctrine.[402] Others assume that the proportionality test shall be used independently regardless recognition of any other doctrine concerning the matter.[403] Due to the fact that the practice of the investment tribunals is far from uniform, some of the scholars even suggest that arbitral tribunals should employ the proportionality test (or similar method of balancing) when resolving the cases of indirect expropriation rather than the doctrines described above.[404]

In any case, the proportionality test provides with another criteria on the basis of which the tribunal can evaluate the state's measures in question on the basis of validity while *stricto sensu* its main aim is to determine "*whether there is a balance between the regulatory objective and the taking that is put into effect*".[405] And thus to distinguish the measures falling under the scope of indirect expropriation requiring compensation and those which are merely non-compensable regulations.[406]

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[400] *Pope & Talbot v Canada*, UNCITRAL, Interim Award, 26 June 2000, para. 99.

[401] SORNARAJAH, Muthucumaraswamy. *Resistance and Change in the International Law on Foreign Investment*. Cambridge: Cambridge University Press, 2015. P. 365.

[402] See, for example, BÜCHELER, Gebhard. *Proportionality in investor-state arbitration*. 1st ed. Oxford, United Kingdom : Oxford University Press, 2015. P. 129.

[403] *Mitchell, A. D., Munro, J., & Voon, T. (2017). Importing WTO General Exceptions into International Investment Agreements: Proportionality, Myths and Risks. SSRN Electronic Journal . doi:10.2139/ssrn.3209861 p. 9.*

[404] BÜCHELER, Gebhard. *Proportionality in investor-state arbitration.* 1st ed. Oxford, United Kingdom : Oxford University Press, 2015. P.122

[405] SORNARAJAH, Muthucumaraswamy. *Resistance and Change in the International Law on Foreign Investment*. Cambridge: Cambridge University Press, 2015. Pp. 222,366.

[406] COTTIER, Thomas et al. The Principle of Proportionality in International Law: Foundations and Variations. *Journal of World Investment & Trade.* 2017, 18. 628, 656, 659. P. 25 *et seq*.

This test has been described as a threefold test which includes the assessment of suitability, necessity and proportionality *stricto sensu* of the state's measures under scrutiny.[407] Additionally, there is also a preliminary assessment which focuses on the regulatory objective, meaning whether the measures serve the public purpose.[408]

After the "public interest" is affirmed in the preliminary phase, the analysis of the three aforementioned elements follows. Hence, in order to be regarded as a non-compensable regulation the measure firstly, to be suitable to protect the interest for the protection of which it has been adopted; secondly, the necessity of the measure requires that there must be no adequate less restrictive measure capable of attaining the objective pursued; lastly, the measure shall not be disproportionate, meaning that the restriction it causes must not be out of proportion to the intended objective or the result.[409]

Being a newness within the ambit of international investment law, the concept of proportionality is not a novelty in the general jurisprudence for it has been already known for quite a long time to numerous jurisdictions in South America, Europe, as well as various common law countries as a mode of balancing between competing rights and interests.[410] It is commonly reported that this test originated from German administrative and constitutional law and for the first time was referred to by the German Constitutional Court in *Apothekenurteil,*[411]

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[407] BÜCHELER, Gebhard. Proportionality in investor-state arbitration. 1st ed. Oxford, United Kingdom : Oxford University Press, 2015. P. 37.

[408] HENCLES, Caroline. Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration. Journal of International Economic Law, 15(1), 223-255. P. 227.

[409] JANS, Jan, H. Proportionality Revisited, *Legal Issues of Economic Integration*.27(3), pp. 239–265, 2000. P.240-241; This test was fully encapsulated for example by the Supreme Court of Canada in the case Regina v Oakes stating that "*First, the measures adopted must be carefully designed to achieve the objective in question. They must not be arbitrary, unfair or based on irrational considerations. In short, they must be rationally connected to the objective. Second, the means, even if rationally connected to the objective in this first sense, should impair 'as little as possible' the right or freedom in question. Third, there must be a proportionality between the effects of the measures which are responsible for limiting the Charter right or freedom, and the objective which has been identified as of 'sufficient importance'."* See, KINGSBURY, Benedict and SCHILL, W. Stephan. Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law. In: BERG, A. J. van den. *50 Years of the New York Convention: ICCA International Arbitration Conference*. Alphen aan den Rijn : Kluwer Law International, 2009, pp. 5 – 68. ICCA Congress Series, Volume 14. P. 33-34.

[410] *Ibid*.

[411] *a case concerning the interference with the freedom of profession of pharmacists by a licensing system that limited the number of pharmacy licenses in order to secure the supply of the population with pharmaceuticals*

where it stated that *"[t]he solution can only be found in each case by **careful balancing** of the importance of the opposing (and possibly actually conflicting) interests"*.[412]

As a method of balancing of the competing maxims or principles, the proportionality test is also deemed to be a concept strongly linked to human rights.[413] Indeed, several for this matter germane cases were resolved before the ECHR and were later referred to by the investment tribunals.

One of the first cases where the ECHR resorted to application of the proportionality test is *James and Others*. This case dealt with the claimants' challenge of the 1967 Leasehold Reform Act on the grounds of deprivation of their property rights as lessees were given an opportunity to purchase the freehold reversion.[414] The ECHR came to conclusion that:

> "*Not only must a **measure depriving a person of his property pursue**, on the facts as well as in principle, **a legitimate aim "in the public interest",** but there **must also be a reasonable relationship of proportionality** between the means employed and the aim sought to be realised."*[415]

The ECHR based these conclusions on the argumentation of the judgement in *Sporrong and Lönnroth* case where the concept of proportionality was expressed as a requirement of "fair balance" in a conflict of "*general interest of the community and the requirements of the protection of the individual's fundamental rights*."[416] The court also concluded that such a "fair balance" would not be inferred in the situation where the aggrieved person would have to bear *"an individual and excessive burden."*[417]

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[412] KINGSBURY, Benedict and SCHILL, W. Stephan. Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law. In: BERG, A. J. van den. *50 Years of the New York Convention: ICCA International Arbitration Conference*. Alphen aan den Rijn : Kluwer Law International, 2009, pp. 5 – 68. ICCA Congress Series, Volume 14. P. 33-34.

[413] BURGHETTO, María, Beatriz and LORFING, Pascale, Accaoui, The Evolution and Current Status of the Concept of Indirect Expropriation in Investment Arbitration and Investment Treaties. *Indian Journal of Arbitration Law*. 2017, VI (2), pp. 98 -123. P.119.

[414] *James and Others v. the United Kingdom*, ECHR case no. 8793/79, judgment of 21 February 1986, paras. 10-11.

[415] *James and Others v. the United Kingdom*, ECHR case no. 8793/79, judgment of 21 February 1986, para. 50

[416] *Ibid*.

[417] *Sporrong and Lönnroth v. Sweden*, ECHR case no. 7151/75 7152/75, Judgment (Merits), 23 September 1982. Para. 73.

While addressing the actual measures adopted to pursue any socially important objective, the ECHR also added that *"a measure must be both appropriate for achieving its aim and not disproportionate thereto."*[418]

Similarly, the ECHR concluded in the case *Mellacher and Others* which dealt with restrictions imposed on the rent that a property owner could charge. Regarding the proportionality the ECHR concluded that *"an interference must achieve a "fair balance" between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights*".[419]

Lastly, as for the measures that could fail the proportionality test the ECHR in *Matos e Silva* observed that

> "*the length of the proceedings, coupled with the fact that it had so far been impossible for the applicants to obtain even partial compensation for the damage sustained, upset the balance which should be struck between protection of the right of property and the requirements of the general interest.*" [420]

Interestingly, until recently[421] the proportionality test has nowise been included in IIAs as a criterion based on which the cases of regulatory takings would have to be assessed. On the contrary, the proportionality test made first its way into the ISDS practice through certain adventurism and creative interpretation of IIAs by arbitral tribunals.[422]

The first (and only) investment tribunal to properly articulate the proportionality test as a method of distinguishing between compensable indirect expropriation and non-compensable regulatory measure was the *Tecmed* tribunal.[423] In order to draw guidance for the use of the

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[418] *James and Others v. the United Kingdom*, ECHR case 8793/79, judgment of 21 February 1986, para. 50.

[419] *Mellacher and Others v. Austria*, ECHR case no. 364455, judgment of December 19, 1989, para. 48; Similarly, was concluded in the case of *Pressos Compañía Naviera* regarding a peaceful enjoyment of possessions. *Pressos Compañía Naviera and Others v. Belgium*, ECHR case no. 17849/91, judgment of 20 November 1995, para. 38.

[420] *Matos e Silva, Lda., and Others v. Portugal*, ECHR case no. no. 15777/89, judgment of 16 September 16, 1996. Para. 91.

[421] the call for the proportionality test made it through to the wordings of several IIAs which are striving to a more balanced approach towards the states' and investors' rights. See, for example, Australia - Indonesia CEPA (2019), Annex 14-B, para.3; ASEAN - Hong Kong, China SAR Investment Agreement (2017), Annex 2, para.3.

[422] SORNARAJAH, Muthucumaraswamy. *Resistance and Change in the International Law on Foreign Investment*. Cambridge: Cambridge University Press, 2015. Pp. 365-366, 374.

[423] HENCLES, Caroline. Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration. Journal of International Economic Law, 15(1), 223-255.

proportionality analysis in determining whether a legitimate regulation turned in fact into indirect expropriation the tribunal relied on the *European Court of Human Rights* jurisprudence, especially the *Matos e Silva* case cited above and *Pressos Compañía Naviera*.[424] The tribunal considered whether regulatory actions in question were "*proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality*".[425]

It then proceeded with the observation that "[*t*]*here must be a* ***reasonable relationship of proportionality*** *between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure*."[426] On the basis of such consideration the *Tecmed* tribunal found the non-renewal of the license as disproportionate and therefore it held that the Mexico's measures constituted indirect expropriation.[427]

Additionally, there were several cases that referred to the certain elements of the proportionality test even though they haven't specifically applied it.

The means of evaluation in the case *S.D. Myers* can be even seen as the forerunner of the proportionality test. Although the tribunal in this case focused primarily on the effect of the measures taking also into consideration the purpose thereof, it has also added an unuttered reference to the "necessity prong" of the proportionality test.[428] Hence, it has observed that "*where a state can* ***achieve its chosen level of environmental protection*** *through a variety of*

P. 230-231; BÜCHELER, Gebhard. Proportionality in investor-state arbitration. 1st ed. Oxford, United Kingdom : Oxford University Press, 2015. P. 123.

[424] MITSI, Mary. *The decision-making process of investor-state arbitration tribunals*. Alphen aan den Rijn : Kluwer Law International, 2019. P. 180.

[425] NEWCOMBE, Andrew and PARADELL, Lluis. Chapter 7 – Expropriation. In: *Law and practice of investment treaties: Standards of treatment.* Alphen aan den Rijn : Kulwer Law International, 2009. P. 363.

Técnicas Medioambientales Tecmed, S.A. v The United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 122.

[426] *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, para. 122.

[427] *Ibid*.

[428] HENCLES, Caroline. Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration. Journal of International Economic Law, 15(1), 223-255. P. 230.

equally effective and reasonable means, it is ***obliged to adopt the alternative that is most consistent with open trade***."[429]

Finally, the few following investment tribunals dealing with the expropriation claims also partly resorted to requirements of the proportionality test. As a matter of fact, these tribunals have addressed the scrutinized measures from the perspective of the police powers doctrine, however, they also added the requirement of the proportionality *stricto sensu* into their deliberation.

Thus, the tribunal in *LG&E* observed that the state has its power to regulate its policies, "*except in cases where the State's action is obviously* ***disproportionate to the need being addressed***."[430] Similarly, the tribunal in *El Paso* relying on the *LG&E* decision formulated the requirement of the "reasonableness and proportionality of State measures interfering with private property".[431] The tribunal in *Total* has come to the same conclusion.[432]

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[429] *S.D. Myers, Inc. v. Canada*, UNCITRAL, Partial Award, 13 November 2000, para 221.

[430] *LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc. v Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, para 195.

[431] *El Paso Energy International Company v The Argentine Republic*, ICSID Case No. ARB/03/15, Award, 31 October 2011, para. 241.

[432] *Total S.A. v Argentine Republic*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, para 123.

4. THE STATE'S RIGHT TO REGULATE IN THE TREATY PRACTICE

It is safe to say that vast majority of IIAs has regularly and traditionally addressed indirect expropriation, however, especially older IIAs were often silent on regulatory measures in relation to indirect takings except for several treaties such as, for example, the US FTAs[433], and the US and Canada Model BITs.[434]

As a matter of fact, in principle, by concluding IIAs states are not supposed to be deemed discarding their right to regulate as it is an inherent part of their sovereignty which the states cannot be divested of.[435] The regime of IIAs is merely limiting the states' capacity to perform this component of their sovereignty.[436] Notwithstanding, as the ISDS practice has shown, whether the state's measures are assessed through the prism of the police powers doctrine, sole effects doctrine or the proportionality test is a matter of tribunal's discretion and thus it is almost impossible to "*pre-judge which measure will be deemed to constitute permissible non-compensable state regulation and which not*."[437] Thus, it also depends on the tribunals whether they would be willing to recognize the foregoing state's right to regulate under IIAs or other

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[433] See, for example, wording of the US-Australia FTA which in its Annex 11-B addresses precisely the relationship between indirect expropriation and regulatory measures;

"Except in rare circumstances, ***nondiscriminatory regulatory actions*** *by a Party that are designed and applied to achieve* ***legitimate public welfare objectives****, such as the protection of public health, safety, and the environment,* ***do not constitute indirect expropriations****.";*

And the US-Jordan FTA, which for instance in its Art. 5(2) (Environment) and similarly in Art. 6(2) (Labour) emphasizes the rights of states to regulate its environmental and labour matters;

*"****Recognizing the right of each Party to establish its own [levels of domestic environmental protection*** *and environmental development policies and priorities/****domestic labour standards****], and to adopt or modify accordingly its [environmental laws/labour laws and regulations], each Party shall strive to ensure that its laws provide for high levels of […] protection and shall strive to continue to improve those laws […].".*

[434] DERAINS, Yves and SICARD-MIRABAL, Josefa. Chapter 5: Expropriation. In: *Introduction to Investor-State Arbitration*. Alphen aan den Rijn : Wolters Kluwer, 2018, pp. 115 – 132. Pp. 122.

[435] As was, for example, mentioned in Lotus case by Judge Weiss: *"****[Sovereignty] does not even require to be embodied in a treaty:*** *that is the rule sanctioning the sovereignty of States. If States were not sovereign, no international law would be possible, since the purpose of this law precisely is to harmonize and reconcile the different sovereignties over which it exercises its sway."* (The Case of the S.S. 'Lotus', France v Turkey, PCIJ Series A, No. 10, 4, Dissenting Opinion of Judge Weiss, 7 September 1927, para. 121).

[436] UNCTAD Preserving Flexibility in IIAs. United Nations Conference on Trade and Development (UNCTAD) Series on International Investment Policies for Development. 20 October 2006. p. 6. (hereinafter UNCTAD IIAs).

[437] TITI, Catharine. *The right to regulate in international investment law*. Baden-Baden : Nomos, 2014. P. 287.

international instruments even where the treaty in question lacks a specific wording relating thereto.

This can be illustrated for instance on the *North Atlantic Fisheries case* where the British argued that the right to regulate as one of the essential attributes of sovereignty "*must be held to reside in the territorial sovereign, unless the contrary be provided*" [438] despite the lack of support therefor in a respective treaty.[439] The tribunal, however, did not agree with this contention.[440] Similarly, the tribunal in *Santa Elena* refused to upheld the state's right to regulate concerning legitimate environmental regulations without a specific reference thereto in the BIT the case was being settled under.[441]

Furthermore, the existing treaty practice has predominantly developed a strong protection-oriented approach giving the investors a wide range of grounds upon which the cases against the host states could be built.[442] One for all, the *Transatlantic Trade and Investment Partnership* (TTIP) treaty has recently risen an upsurge of concerns about the erosion of the state's sovereign right to regulate due to apprehension about potential disputes brought before international tribunals by the investors.[443] Particularly as problematic was deemed the TTIP's Article 7 which "*[would give] foreign companies the right to sue national and regional governments for compensation, whenever their access to markets [would be] unfairly impeded by local legislation and whenever their 'legitimate' expectations [would be] frustrated*."[444]

As has been partly implied above, some of the scholars even argue that this treaty practice could lead to a regulatory "freeze" especially as regards laws strengthening environmental

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[438] *The North Atlantic Coast Fisheries Case (Great Britain v United States of America*), PCA Case No. XI RIAA 167, Award 7 September 1910, para. 180.

[439] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P. 157.

[440] The North Atlantic Coast Fisheries Case (Great Britain v United States of America), , PCA Case No. XI RIAA 167, Award 7 September 1910, para. 182.

[441] *Compañia del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award, 17 February 2000, para. 71

[442] PUPOLIZIO, Ivan. The Right to an Unchanging World. Indirect Expropriation in International Investment Agreements and State Sovereignty. *SSRN Electronic Journal*. 2015. P. 5.

[443] BALAŠ, Vladimír and ŠTURMA, Pavel. *Nové mezinárodní dohody na ochranu investic*. Praha : Wolters Kluwer, 2018, ISBN 978-80-7598-100-4. P. 39.

[444] Transatlantic Trade and Investment Partnership (TTIP), update no.1, April 2014, para. 7.1; available at https://eua.eu/downloads/publications/ttip-update-no-1-apr-2014.pdf

protection.[445] The host states' reluctance to incorporate laws due to the fear of being forced to pay heavy compensations in the case of dispute settlement sought by the aggrieved investors is often referred to as the "regulatory chill".[446] The problem of "regulatory chill" has been subjected to a thorough discussion already by several scholars and arbitrators, calling for a more balanced approach towards the states' and the investors' rights within the ambit of ISDS.[447]

Thus, not only the ISDS practice, but also the treaty practice is currently highly concerned with solving this Rubik's cube of the relationship between the state's right to regulate and indirect expropriation. Apparently, drafting a well-balanced treaty which could establish an equilibrium between the public and private rights of states and investors is almost an alchemy.[448]

Treaty practice regarding states' right to regulate is not a novelty introduced to the international law by IIAs. Contrarily, there are several legal instruments that have expressly recognized the existence of non-compensable regulations even long before the IIAs' era.

For instance, the state's right to regulate its internal matters often appeared in the so-called friendship, commerce and navigation (FCN) treaties.[449] Hence, the 1948 US-Italy FCN states that "[*t*]*he provisions of this Treaty shall not be construed to affect existing laws and regulations of either High Contracting Party in relation to immigration or the right of either High Contracting Party to adopt and enforce laws and regulations relating to immigration.*"[450]

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[445] See, for example in BAETENS, Freya. Foreign Investment Law and Climate Change: Legal Conflicts Arising from Implementing the Kyoto Protocol Through Private Investment. *The Center for International Sustainable Development Law & The International Development Law Organization*. 2010. P. 8 et seq; for further discussion, see MILES, Kate. International Investment Law and Climate Change: Issues in the Transition to a Low Carbon World. SSRN Electronic Journal. 2008.

[446] CRAWFORD, James. Chapter 27: The Kyoto Protocol in Investor-State Arbitration: Reconciling Climate Change and Investment Protection Objectives. In: SEGGER, Marie-Claire, GEHRING, Markus W. and NEWCOMBE, Andrew. *Sustainable development in world investment law*. Alphen aan den Rijn : Kluwer Law International, 2011. ISBN 978-90-411-3166-9. Pp 696-697.

[447] SHEKHAR, Satwik. Regulatory Chill: Taking the Right to Regulate for a Spin. *Indian Institute of Foreign Trade: Centre for WTO Studies*. 2016, Working Paper CWS/WP/200/27. P. 13-15.

[448] According to *Dr. Titi* the dilemma stems from the fact that "*drafting the clause in too general terms, [would mean] risking the loss of its effectiveness [and] drafting it too explicitly, enumerating its specific domains, [would mean] the risk consisting in the possible incompleteness of the enumeration*".

TITI, Catharine. *The right to regulate in international investment law*. Baden-Baden : Nomos, 2014. P. 172.

[449] *Ibid*., p. 54.

[450] US-Italy FCN (1948), Article XXIV(7).

Also, the 1961 Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens reads that "*an uncompensated taking of property of an alien or a deprivation of the use or enjoyment of property of an alien which results from the execution of the tax laws; from a general change in the value of currency; from the action of the competent authorities of the State in the maintenance of public order, health, or morality; or from the valid exercise of belligerent rights; or is otherwise incidental to the normal operation of the laws of the State shall not be considered wrongful.*"[451]

Similarly, according to the commentary to the Restatement Third of Foreign Relations Law of the United States "*a state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action [which is] within the police power of states […].*"[452]

Additionally, the *Charter of Economic Rights and Duties of States,*[453] the preamble of the WTO's GATS,[454] and the European Convention on Human Rights[455]

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[451] "*Harvard draft convention on the International Responsibility of States for Injuries to Aliens", In:* SOHN, Louis B. and BAXTER, R. R. Responsibility of States for Injuries to the Economic Interests of Aliens: II. Draft Convention on the International Responsibility of States for Injuries to Aliens. *The American Journal of International Law.* 1961, 55(3), 548. Article 10(5).

[452] *"Restatement (Third) of the Foreign Relations Law of the United States"*, § 712, comment g. In: ANON. Restatement of the Law, Third, Foreign Relations Law of the United States. *The American Law Institute*. Case Citations, Rules and Principles, Part VII, Chapter II - Injury to Nationals of Other States, Restat 3d of the Foreign Relations Law of the U.S., § 712.

[453] "*each State has **the right [t]o regulate** and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities*."

Charter of Economic Rights and Duties of States, UN. Doc. A/RES/29/3281, 12 December 1974, GA Res. 3281 (XXIX), 29 Sess. in its Article 2

[454] ***"recognizing the right of Members to regulate**, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives and, given asymmetries existing with respect to the degree of development of services regulations in different countries, the particular need of developing countries to exercise this right*."

General Agreement on Trade and Services, 15 April 1994, Marrakesh Agreement Establishing the World Trade Organisation, Annex 1B, 1869 U.N.T.S. 183,33 I.L.M. 1167 (1994), Preamble.

[455] Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms, Paris, 20.III.1952, Article 1, Protection of property;

*"The preceding **provisions shall not, however, in any way impair the right of a State to enforce such laws** as it **deems necessary to control the use of property** in accordance with the **general interest** or to secure the payment of taxes or other contributions or penalties.".*

As regards the international investment law, in the course of time and development of the language of IIAs, the states opted for inclusion of certain provisions therein that would codify and thus reaffirm their right to regulate in order to find a balance between public and private rights.[456] Especially the new generation of IIAs started to include provisions emphasizing and affirming the state's right to regulate.[457] According to the OECD paper as of 2005 "*an increasing number of agreements refer to the role of governments to pursue other policy goals*."[458]

To set the record straight, treaty practice of IIAs with variable degrees has already recognized the state's right to regulate.[459] For example, the first BIT signed in 1959 between Pakistan and Germany referred to the state's right to regulate in its protocol stated that "*measures taken for reasons of public security and order, public health or morality shall not be deemed as discrimination within the meaning of Article 2*".[460] Nevertheless, striving for more balanced IIAs, i.e. elaborating the equilibrium between the protection of foreign investors and state's right to regulate (especially concerning indirect expropriation), is more of a recent phenomenon.

As regards this practice the opinion thereon within the circle of arbitrators, scholars and other professionals in international investment law differs.

According to some of the scholars such practice is utterly redundant for the right to regulate is a norm of a customary international law and as such shall be recognized without any specific treaty provision thereon. As was observed by *Dr. Rajput* such practice "*is merely a reaffirmation of the right in customary law*" further adding that "*if it were argued that States could regulate only if they are so permitted or obliged due to other natural or international obligations, it would introduce artificial and impractical rigidity.*"[461]

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[456] BÜCHELER, Gebhard. *Proportionality in investor-state arbitration*. 1st ed. Oxford, United Kingdom : Oxford University Press, 2015. P.122.

[457] BALAŠ, Vladimír and ŠTURMA, Pavel. *Nové mezinárodní dohody na ochranu investic*. Praha : Wolters Kluwer, 2018, ISBN 978-80-7598-100-4. P. 39.

[458] OECD. *International investment perspectives*: 2006 Edition. París : OECD. 2006. P. 176.

[459] TITI, Catharine. *The right to regulate in international investment law*. Baden-Baden : Nomos, 2014. P. 53.

[460] Germany-Pakistan BIT (1959), *Protocol* (2).

[461] RAJPUT, Aniruddha. *Regulatory freedom and indirect expropriation in investment arbitration*. Netherlands : Wolters Kluwer, 2019. P. 113.

Indeed, this is an understandable argument, however, if that was the case then the prevailing practice of the investment tribunals in cases of indirect expropriation would be police powers doctrine (or a similar approach which applies the state's right to regulate even without its express affirmation in the respective treaty). Nevertheless, as discussed before, this is not the case as the sole effects doctrine is still very popular among the tribunals which highly concerns the states as the outcome of the investment disputes is thus often unpredictable. [462] Additionally, according to *UNCTAD* including such provisions is one of the key means of securing the state's regulatory activity while protecting its flexibility under the network of IIAs.[463]

Consequently, as regards the contemporary treaty practice, there are several different ways of incorporating and affirming the state's regulatory power in IIAs.[464]

First and foremost, the states started to include obligation-specific exclusions to the respective expropriation clauses. As the term itself indicates, these exceptions apply to the respective standards of protection included in IIAs; usually those are the non-discrimination provisions of national treatment and most-favoured-nation treatment.[465] These provisions would commonly appear either in the clause concerning expropriation or in the corresponding annexes which bring further definition to the notion of indirect expropriation.[466]

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[462] MANN, Howard. Investment Agreements and the Regulatory State: Can Exception Clauses Create a Safe Heaven for Governments? *Issues in International Investment Law, Background Papers for the Developing Country Investment Negotiators' Forum*. Singapore, 2007, 1-2. P.5.

[463] UNCTAD IIAs, p. 6.

[464] SOLOMOU, Alexia. *Chapter 15: Exceptions to a Rule Must Be Narrowly Construed.* In: KLINGLER, Josef. Between the lines of the Vienna Convention?:canons and other principles of interpretation in public international law. Alphen aan den Rijn : Wolters Kluwer, 2019. Pp. 359-386. pp. 359 – 386.

[465] SABANOGULLARI, Levent. *General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities*. Baden-Baden : Nomos, 2018. P. 44.

[466] *Ibid*.

For the treaty wordings see, for example, Austria-Tajikistan (2010) BIT, Article 7, Subsection 4; Canada- Moldova (2018) BIT, Annex 10.B, subsection C:

"*Except in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith, non-discriminatory measures of a Contracting Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation*."

Additionally, Colombia-Korea (2013) FTA, Article 5, Subsection 6:

The notion of the state's right to regulate has also slowly started to appear in the preambles of the respective IIAs.[467] To this day, there are however not that many IIAs that would recognize the state's right to regulate within their preamble; out of all the 2577 IIAs mapped by UNCTAD only 45 have such a phasing.[468]

Lastly, some of the IIAs contain wording only seemingly supportive of the state's right to regulate but in fact are mere interpretive guidelines with no practical applicability.[469] These will be in detail addressed further.

These provisions, however, in no case shall be understood as permissible norms under which the states are allowed to regulate regardless any impact of the measures and their consequent liability therefor.

Apart from the aforementioned clauses, affirming the state's right to regulate, the treaty practice is also familiar with the general provisions that allow to exempt certain measures of states from IIAs' regime or from the obligations imposed by IIA as a whole. The thesis follows with the discussion concerning such clauses.

"*This article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights in accordance with the TRIPS Agreement, or to the revocation, limitation, or creation of intellectual property rights*."

[467] MANN, Howard. Investment Agreements and the Regulatory State: Can Exception Clauses Create a Safe Heaven for Governments? *Issues in International Investment Law, Background Papers for the Developing Country Investment Negotiators' Forum*. Singapore, 2007, 1-2. P. 7.

[468] Investmentpolicy.unctad.org. (2019). *Mapping of IIA Content | International Investment Agreements Navigator | UNCTAD Investment Policy Hub*. [online] Available at: https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping [Accessed 3 Dec. 2019].

For example, NAFTA preamble states "*The Government of Canada, the Government of the United Mexican States and the Government of the United States of America, resolved to: PRESERVE their flexibility to safeguard the public welfare*;"

Similarly, Algeria - Russian Federation BIT (2006);

[469] NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 509.

See, for example, India - Korea, Republic of CEPA (2009), Article 10.16; Rwanda - United States of America BIT (2008), Article 12 subsection 2; NAFTA, Article 1114;

Nothing in this Agreement shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Agreement that is in the public interest, such as measures to meet health, safety or environmental concerns."

GENERAL EXCEPTIONS

1. GENERAL EXCEPTIONS IN GENERAL

While speaking about the state's right to regulate and the ways of expressing it in the treaty practice it is important to elaborate on a considerably new phenomenon of the so-called general exceptions clauses (hereinafter also as the "**GEC**").[470]

Along with the obligation-specific exceptions and precise phrasing of the IIAs' preambles, the GECs are perceived as additional and the most complex way of incorporating an express right to regulate in IIAs.[471]

In principle, the GECs are intended to be applicable to the IIA in question as a whole.[472] The fundamental objective behind this is to exempt host states from liability for violating any of the standards of protection in IIAs when adopting regulations of society-wide importance, which purports to bring more balance between the goals of public policy and the investors' protection.[473]

Indeed, such clauses are primarily exploitable in the situations when it is necessary to achieve certain policy goals which are almost impossible to reach in nowadays market liberalization; in which context *prof. Kurtz* observed that "*many older BITs classically oblige states to enable free transfer of capital associated with all covered investments and do not – in general – allow for the imposition of restrictions for balance-of-payments or other reasons*.[474]

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[470] For the purpose of this thesis, the notion General Exceptions Clauses is discussed in a *stricto sensu* connotation, meaning solely the genuine GECs mostly based on the WTO law and other similar clauses. The subsection 1.2, however, do provide certain insight on the exceptions and carve-outs in more general sense in order to show the differences therebetween.

[471] TITI, Catharine. The right to regulate in international investment law. Baden-Baden : Nomos, 2014. P. 169.

[472] SABANOGULLARI, Levent. General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities. Baden-Baden : Nomos, 2018. P. 40.

[473] LÉVESQUE, Céline. The inclusion of GATT Article XX exceptions in IIAs: a potentially risky policy. In: ECHANDI, Roberto, SAUVÉ,Pierre. *Prospects in International Investment Law and Policy: World Trade Forum*. New York : Cambridge University Press Policy. 2013, pp. 363–370. P. 363.

[474] KURTZ Jürgen. *The WTO and international investment law*. Cambridge : Cambridge University Press, 2016. P. 173.

To illustrate the aforementioned, let us imagine the following situation.[475] A developing state signs a mining contract with an investor. The contract concerns operation of one-of-a-kind mining pit specialized exclusively in exploitation of a rare earth metal. However, as activities of the investor go by, it becomes known that the by-product of the mining activity is a toxic waste which is highly detrimental to the environment of the state in question as well as health of its population. Hence, the state is constrained to prohibit operation of the mining pit.

Being it under a standard IIA, the state would basically find itself in a situation when it would have to "buy" a possibility to protect health of its own citizens as well as the environment (that is under consideration that the respective tribunal deciding upon the case would rule out the application of police powers doctrine). Picturing it like this, no wonder the situation starts to acquire fairly risible colours.

Followingly, the idea of incorporating GECS into IIAs was triggered by the latest developments in ISDS practice which, according to several scholars and arbitrators, started to seem to have a suppressing effect on the host states' capacity to regulate.[476]

By inclusion of GECs the states aspire to reach certain recalibration of the relationship between the protection of investors and pursuance of non-economic interests by the states.[477] The practice of incorporating such clauses into IIAs is, however, neither long existing nor widely employed. Contrarily, according to the UNCTAD IIAs Navigator, only approximately[478] 121 out of 2 571 BITs contain a general public policy clause or GEC.[479] Moreover, about ¾ of these IIAs were concluded only after the year 2000 with an increasing

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[475]ANON., 2019. Fdimoot.org [online] [Accessed. 1. November 2019]. Available at: https://www.fdimoot.org/Archive/2018/2018problem.pdf.

[476] See, for example, MITCHELL, Andrew D., MUNRO, James and VOON, Tania. Importing WTO General Exceptions into International Investment Agreements: Proportionality, Myths and Risks. *Forthcoming, Yearbook of International Investment Law and Policy 2016-2017 ;U of Melbourne Legal Studies Research Paper.* Oxford : Oxford University Press, 2018, No. 757.; KURTZ Jürgen. *The WTO and international investment law*. Cambridge : Cambridge University Press, 2016.; and TITI, Catharine. The right to regulate in international investment law. Baden-Baden : Nomos, 2014.

[477] SABANOGULLARI, Levent. General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities. Baden-Baden : Nomos, 2018. ISBN 978-3-8452-9193-2. P. 25.

[478] *The number is only indicative due to the possible flaws in the searching algorithm.*

[479] Investmentpolicy.unctad.org. (2019). Mapping of IIA Content | International Investment Agreements Navigator | UNCTAD Investment Policy Hub. [online] Available at: https://investmentpolicy.unctad.org/international-investment-agreements/iia-mapping [Accessed 3 November 2019].

tendency in the past 9 years.[480] Consequently, to this date only about 5% of the IIAs (meaning primarily the BITs) contain such provisions, which is indeed very few.

Similarly, as in the case of the concept of indirect expropriation and right to regulate, there are several issues regarding the matter which have not yet been resolved.

Primarily, the novelty of this phenomenon constitutes one of the prominent issues connected thereto. More precisely, the problem is that the treaty practice is yet to become steady and uniform. As regards the aforementioned, there are still more IIAs that do not contain the GECs but rather other means of reinforcement of the state's right to regulate (if any). Not to mention variances of the phrasing of the GECs among different IIAs.

Further difficulty revolving around the incorporation of the GEC into IIAs is that there is no uniform opinion on whether those clauses are necessary in IIAs.[481] In fact, according to *prof. Newcomb* there is no much area for the GECs to have a practical significance within the framework of international investment law. Accordingly, also the applicability of the GECs is problematic due to their origin, i.e. the law of WTO.[482]

Lastly, neither there is a unanimous opinion regarding the relationship of the GECs and the other means of securing the state's regulatory flexibility in IIAs (especially as regards the explanatory Annexes to the clauses on expropriation or obligation-specific clauses).

1.1 What are general exceptions clauses?

The states started to incorporate GECs into their IIAs with an increasing tendency in the past two decades. Those clauses were mostly either inspired by or directly "transplanted" from the WTO law into the respective investment treaties.[483] Thus, vast majority of the GECs are

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[480] *Ibid*.

[481] For example, according to Federico Ortino *"there is no need to provide general exception provisions[…] as the prerogative to adopt measures to pursue legitimate public policies is inherent in the substantive guarantees based on non-discrimination and reasonableness."*

ORTINO, Federico. Substantive Provisions in IIAs and Future Treaty-Making: Addressing Three Challenges. *SSRN* [online]. 27 June 2015. [Accessed 1 November 2019]. Available from: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2623545. P. 4.

[482] Primarily, as for the fact that these bodies of law are governed by different bodies of rules and apply to very divergent set of relationships as is also discussed below.

[483] SABANOGULLARI, Levent. *General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities*. Baden-Baden : Nomos, 2018. P. 290.

either based on the Article XX GATT or Article XIV GATS.[484] Some of the contemporary agreements, however, contain *sui generis* GECs.[485]

As expressed above, unlike the obligation-specific clauses, the GECs are intended to exempt certain legitimate policy objectives from the application of the IIA in question as a whole. By the means of the GECs states strive to exempt measures "*necessary to protect human, animal or plant life or health, or for the conservation of exhaustible natural resources, public morals,*" and others.[486]

The typical structure of the GEC contains three important parts – the so called "*chapeau*" which prevents the states from adopting discriminatory and arbitrary measures and introduces the exceptional nature of the public welfare objectives below; the list of legitimate public interest objectives (such as protection of the public order, health, environment, etc.); and the part which expresses the nexus requirement between the pursued objectives and the means adopted to achieve them.[487]

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[484] BALAŠ, Vladimír and ŠTURMA, Pavel. *Nové mezinárodní dohody na ochranu investic*. Praha : Wolters Kluwer, 2018. P. 40.

[485] SABANOGULLARI, Levent. *General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities*. Baden-Baden : Nomos, 2018. P. 81 et seq.

[486] UNCTAD. World investment report 2010: investing in a low-carbon economy. *United Nations Conference on Trade and Development (UNCTAD) World investment report.* 22 July 2010. New York,: United Nations. P. 124. (hereinafter UNCTAD 2010)

[487] For illustration, a typically built GEC can be seen, for example, in Australia - China FTA (2015), Article 9.8 which reads as follows:

"*1. For the purposes of this Chapter and subject to the requirement that such measures are not applied in a manner which would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures: [**being a chapeau**]*

(a) necessary to protect human, animal or plant life or health;

(b) necessary to ensure compliance with laws and regulations that are not inconsistent with this Agreement;

(c) imposed for the protection of national treasures of artistic, historic or archaeological value; or - 90 –

(d) relating to the conservation of living or non-living exhaustible natural resources."

[***"necessary to" encompasses the nexus requirement; letters a-d contain the permissible objective***]

1.2 What are general exceptions clauses not?

Apart from the GECs, the treaty practice also knows several other in nature very familiar provisions. Even though those seem to be similar to the GECs, it is necessary to distinguish these therefrom.

Firstly, the clauses that largely resemble the GECs are the essential security clauses also known as the necessity provisions (hereinafter as the "**ESC**").[488] Unlike the GECs though, these are more frequently incorporated into IIAs and are not as novel to the world of international investment law as the GECs are.[489] Moreover, there is a considerably larger body of the case law provided by the investment tribunals which dealt not only with application but also with the interpretation of the ESCs.[490]

There are also several important structural and substantial differences to be addressed. Most importantly, the purpose and nature of the ESCs is diametrically divergent from the GECs. As a matter of fact, the ESCs codify the state's right to act in situations when the very existence thereof is imminently jeopardized, and the states are no longer capable of fulfilling their obligations under the respective IIAs.[491]

Hence, the wording of the ESCs usually reads:

"*Nothing in this Treaty shall be construed:*

a) to require a Contracting Party to furnish any information the disclosure of which is deemed contrary to its essential security interests;

b) to preclude a Contracting Party from applying measures that it considers necessary for the protection of its essential security interests, including measures adopted:

i. in times of war, armed conflict, or other types of emergencies occurred in the territory of either Contracting Party or in respect of international relations;

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[488] For the connotation of the term, see NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 484, 488 *et seq*.

[489] SABANOGULLARI, Levent. General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities. Baden-Baden : Nomos, 2018. P. 42.

[490] For example, *Continental*, *CMS* and *Enron.*

[491] SABANOGULLARI, Levent. General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities. Baden-Baden : Nomos, 2018. P. 43.

ii. for the implementation of national policies or in compliance with international agreements regarding the non-proliferation of weapons."[492]

As illustrated by this example, the last difference to mention is that, unlike the GECs with their "*chapeau*"[493] the ESCs usually do not contain any safeguards from arbitrary and discriminatory measures which emphasizes their nature as an *ultima racio* protection in the times of distress.

Nevertheless, there are also two things that both the ESCs and the GECs have in common. Firstly, they both apply to the IIA in question as a whole, exempting the state from any standard of investors' protection;[494] secondly, likewise in case of many GECs, some of the IIAs incorporate the ESCs directly from the law of WTO.[495]

Additionally, one can encounter the so called "carve-outs" which usually include measures protecting the financial market of the host state or ensure integrity and stability of the state's financial system; some even exclude all financial services in their entirety.[496] Hence, for example India – Korea CEPA in its Article 10.2 subsection 7 states: "*This Chapter shall not apply to measures adopted or maintained by a Party with respect to financial services*."[497] In addition, IIAs also often expressly carve out taxation measures from the application thereof.[498] As follows from the nature of these "carve-outs" clauses, however, neither these are to be regarded as general exceptions for the respective IIAs are not to be applied to the caved-out fields in the first place.

As also mentioned in the previous Chapter, there are the so-called obligation-specific exceptions which are often incorporated into the "expropriation" clauses (usually by the means

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[492] Australia-China FTA (2015), Article 16.3, Security Exceptions "*Article XXI of GATT 1994 and Article XIV bis of GATS are incorporated into and made part of this Agreement, mutatis mutandis*."

[493] For the connotation of the term see the Chapter 2. below.

[494] NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 484.

[495] For example, Argentina - Qatar BIT (2016), Article 13.

[496] UNCTAD 2010, p. 124.

[497] India - Korea, Republic of CEPA (2009), Article 10.2.

[498] For example, Peru - Singapore BIT (2003), Article 5, subsection 2 "*The provisions of this Agreement shall not apply to matters of taxation. Such matters shall be governed by any Avoidance of Double Taxation Treaty between the two Contracting Parties and the domestic law of each Contracting Party*."

of Annexes). These are, however, not supposed to be applicable to the whole treaty in question and thus shall not be mistaken for GECs either.

Lastly, some of the IIAs contain the following wordings:

"*Nothing in this Agreement shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Agreement that is in the public interest, such as measures to meet health, safety or environmental concerns.*"[499]

These are, nonetheless, mere interpretive guidelines.[500] Due to the fact, that the wording of these provisions itself addresses the "*measures otherwise consistent with*" the respective IIAs, these provisions have little to no significance and cannot be regarded as exceptions.

According to *Newcombe & Paradell,*

"this type of provision is tautological [and] does not provide additional regulatory flexibility for environmental measures. At most it might serve as an interpretive presumption that non-discriminatory environmental measures made in good faith do not contravene investment obligations."[501]

1.3 Interpretation of general exceptions clauses

"*Exception lies at the crossroads of multiple legal questions*."[502]

Indeed, when considering the notion of the exceptions themselves, especially in such complex tools as IIAs undoubtedly are, it is necessary to take into consideration all the variables and possible repercussions as many is at stake.

As has been outlined in the introduction of this Part, there is little to no agreement yet on the application and interpretation of the GECs within the ambit of international investment law. There are many questions related to the existence of the GECs within the ambit of international investment law for answering which the GECs have yet to undergo a closer scrutiny of the investment tribunals and scholars. Interpretation of the GECs is one of these questions.

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[499] See, for example, India - Korea, Republic of CEPA (2009), Article 10.16; Rwanda - United States of America BIT (2008), Article 12 subsection 2; NAFTA, Article 1114.

[500] NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 509.

[501] *Ibid*.

[502] BENEDETTO, Saverio Di. International investment law and the environment. Cheltenham : Edward Elgar Publishing, 2014. P.158-162.

For the purposes of the WTO the Appellate Body has defined the GECs as affirming "*the **right of Members to pursue objectives identified** in the paragraphs of these provisions even if, in doing so, Members act **inconsistently with obligations** set out in other provisions of the respective agreements, provided that all of the conditions set out therein are satisfied.*"[503] Moreover, the Appellate Body has dismissed the narrow interpretation of the GECs by the WTO Panels.[504]

According to *prof. Newcombe* such an approach would be preferable also in the field of international investment law.[505] However, on the contrary, for example *Alexia Solomou* has argued, with reference to the Latin maxim "*exceptio est strictissimae applicationis*" and on the basis of the difference of the GECs from mere reservations, that such exceptions have to be applied narrowly.[506]

2. TREATY PRACTICE AND EXCEPTIONS CLAUSES

As mentioned above, only a fraction of all the IIAs that nowadays govern the investment relations between states and investors contain the said GECs.

Yet, the treaty practice concerning the matter is already quite divergent. Not only model IIAs of different states vary in the wordings of the GECs but also each of the states have fairly inconsistent practice as regards drafting IIAs.

Many of the IIAs' GECs are based on Article XX GATT or Article XIV GATS, some are, however, combining both, and some are rather sui generis.[507] Furthermore, the treaties have

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[503] *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, Appellate Body Report, WT/DS285/AB/R, adopted 20 Apr. 2005, para. 291. In NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 486.

[504] *European Communities – Measures Concerning Meat and Meat Products*, Appellate Body Report, WT/DS26/AB/R and WT/DS48/AB/R, 16 January 1998, para. 104.

[505] NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 486.

[506] SOLOMOU, Alexia. *Chapter 15: Exceptions to a Rule Must Be Narrowly Construed.* In: KLINGLER, Josef. Between the lines of the Vienna Convention?:canons and other principles of interpretation in public international law. Alphen aan den Rijn : Wolters Kluwer, 2019. Pp. 359-386. P. 359.

[507] SABANOGULLARI, Levent. *General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities*. Baden-Baden : Nomos, 2018. P. 67,81.

different approaches to the placement of the GECs as well as the terminology related thereto.[508] Not mentioning the scope of permissible objectives exempted from the application of the respective IIAs.

Nonetheless, even though the treaty practice concerning the GECs is highly disparate there are several basic structural elements thereof that are similar throughout most of the IIAs.[509]

The wording of the GECs frequently begins with or includes in some of its subsections a so called "*chapeau*" which is a paragraph establishing a set of conditions under which the "excluded" measures are adoptable.[510] The *chapeau* sets forth a rule that measures adopted for legitimate objectives listed in the subparagraphs of the GEC are not to be

> "***applied in a manner*** *which would constitute a means of* ***arbitrary or unjustifiable discrimination*** *between countries where the same conditions prevail, or a disguised restriction on international [trade or] investment*".[511]

That follows exactly the wording of the *chapeaux* of the GATT and GATS GECs.

According to the Appellate Body Report *US–Shrimp* the *chapeau* encompasses a safeguard against arbitrary or discriminatory measures.[512] Without such wording installed in the head of the GECs objectives, it would lead to

> "*permission of one [Member State] to* ***abuse or misuse its right to invoke an exception*** *[which would effectively lead] to allowing that [Member State] to* ***degrade its own treaty obligations as well as to devalue the treaty rights of other [Member States]***." [513]

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[508] TITI, Aikaterini. The right to regulate in international investment law. Baden-Baden : Nomos, 2014. P. 171; BURKE-WHITE, William W., VON STADEN, Andreas. Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties. *Virginia Journal of International Law.* U of Penn Law School. 2007, Vol. 48, p. 307-410. P. 325.

[509] *Ibid*., p. 329.

[510] BARTELS, Lorand. The Chapeau of the General Exceptions in the WTO GATT and GATS Agreements: A Reconstruction? *The American Journal of International Law*. 2015, Vol. 109, no. 1, pp. 95-125. P.96.

[511] See, for example, Japan-Uruguay BIT (2015), Article 22, which, interestingly, combines general and security exceptions; Australia-China FTA (2015), Article 9.8; ASEAN-India IPPA (2014), Article 21; or Latvia-Armenia BIT (2005), Article 13.

[512] *United States – Import Prohibition of Certain Shrimp and Shrimp products*, Appellate Body Report, WT/DS58/AB/R, adopted 6 November 1998, para. 156.

[513] *Ibid*.

That makes the *chapeau* one of the most important parts in the structure of the GECs.[514] Otherwise, incorporating such a clause would be a potentially risky policy which could disrupt the very essence of the IIA in question as the investors' protection thereunder could be effectively emptied. Thus, most of the IIAs do install either the *chapeau* inspired or directly borrowed from Article XX GATT or Article XIV GATS or they incorporate other effective safeguards against abusive invocation of general exceptions such as notification requirements as well as other good faith and non-discrimination requirements.[515]

Additionally, as stated by the Appellate Body Report *US-Gasoline* the purpose of the *chapeau* is not "*so much the [assessment of the] questioned measure or its specific contents as such, but rather the manner in which that measure is applied*".[516] It follows that a sober scrutiny under a *chapeau* implies application of the proportionality test which requires that no less severe measures are available.[517]

The GECs also always contain a wording introducing the set forth objectives under which exceptional derogations from the IIA in question are permissible. Usually the phrasing is that "*nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Party of measures*" which are necessary for the objectives set forth further.[518] Such wording either follows the "safeguard" part of the *chapeau*,[519] if included, or it is installed in a separate subsection.[520]

Interestingly, for example *prof. Levesque*, besides other issues, ruminated over the question whether such wording actually implies that the successful invocation of such a clause

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[514] SABANOGULLARI, Levent. *General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities*. Baden-Baden : Nomos, 2018. P. 174.

[515] *Ibid*., P. 106; for the wording see, for example, Rwanda-Turkey BIT (2016), Article 5; Bangladesh-Turkey (2012), Article 5.

[516] *United States – Standards for Reformulated and Conventional Gasoline*, Appellate Body Report, WT/DS2/AB/R, adopted 20 May 1996, p. 22.

[517] HERDEGEN, Mathias. *Principles of International Economic Law*. 2nd ed. Oxford : Oxford University Press, 2016. P. 238.

[518] See, for example, Finland-El Salvador BIT (2002), Article 14; Gabon-Turkey BIT (2012), Article 5.

[519] See, for example, Colombia-Japan BIT (2011), Article 15; EU-Georgia Association Agreement (2014), Article 134.

[520] See for example Finland-Namibia BIT (2002), Artcile 16; Rwanda-Turkey BIT (2016), Article 5; Armenia-Latvia BIT (2005), Article 13.

would exempt a state from its obligation to promptly compensate the aggrieved investor.[521] *Prof. Levesque* argued that if that was a case it would mean that the states intended to provide less protection to the investors than they are provided for by customary international law.[522] This point of view seems understandable, however, if that was the case GECs would basically serve no purpose. As a matter of fact, the rationale behind incorporating those clauses is precisely the states' aspiration to exempt themselves from liability for the breach of IIA resulting from pursuance of miscellaneous policy objectives.[523] Moreover, as was concluded by *Alvarez & Birke*, nothing prevents the parties to, at the conclusion of IIAs, freely limit investor protections, including those under customary international law.[524]

Before proceeding to the permissible objectives, it is imperative to mention the so called "nexus requirement" which is also very commonly used in the GECs. Such requirement resides in the fact that in order to be covered by the GEC the challenged measures, otherwise in contravention with the corresponding IIA, must be sufficiently related to the permissible objectives specified therein.[525] The phrase most frequently used is "*necessary to*" or "*which it considers necessary*" to achieve any of the objectives listed in the clause. Further wordings use words such as "*relating/related to*", "*directed to*", "*imposed for*", and others. Only very few IIAs lack such nexus requirement.[526] Followingly, the rigidity of the nexus requirement varies throughout different IIAs and the looser it is the greater regulatory freedom it guarantees.[527]

The disunity in the wordings of the nexus requirement in IIAs and certain level of ambiguity of the term itself have naturally necessitated a closer scrutiny within the practice of

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[521] LÉVESQUE, Céline. The inclusion of GATT Article XX exceptions in IIAs: a potentially risky policy. In: ECHANDI, Roberto, SAUVÉ,Pierre. *Prospects in International Investment Law and Policy: World Trade Forum*. New York : Cambridge University Press Policy. 2013, pp. 363–370. P. 368.

[522] *Ibid*.

[523] SABANOGULLARI, Levent. *General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities*. Baden-Baden : Nomos, 2018. P. 293.

[524] ALVAREZ, José E., BRINK, Tegan. Revisiting the Necessity Defense. *Yearbook of international investment law and policy 2010-2011*. NYU School of Law, Public Law Research Paper. 2011, 11(09). P.344.

[525] BURKE-WHITE, William W., VON STADEN, Andreas. Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties. *Virginia Journal of International Law.* U of Penn Law School. 2007, Vol. 48, p. 307-410. P. 330.

[526] SABANOGULLARI, Levent. *General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities*. Baden-Baden : Nomos, 2018. P. 103

[527] TITI, Catharine. *The right to regulate in international investment law*. Baden-Baden : Nomos, 2014. P. 191

the investment tribunals (as well as WTO Panels and the Appellate body) which is addressed below.

Lastly, the heart of the GECs are the permissible objectives. When assessing the challenged measures, those that fall under such permissible objectives could be inconsistent with the other provisions of the IIA in question and still would not trigger the states' liability therefor.

The number and nature of these permissible objectives vary in different IIAs. Usually, the states incorporate health or environment-related, compliance with laws, protection of public order and morals objectives.[528] One of the mostly occurring objectives is taxation as that is deemed to be an essential attribute of the state's fiscal sovereignty.[529]. Hence the taxation measures are often completely and unconditionally exempted from the application of the respective IIAs either under the GECs or in another similar provisions.

To illustrate the foregoing, the following provides with the wordings of GECs of several IIAs in order to compare the structure and the scope thereof. IIAs are specifically chosen in order to cover all the different kinds thereof as well as different types of the GECs incorporated therein. Thus, the following elaborates more on IIAs containing GECs based on the Article XX GATT, Article XIV GATS, both those articles and sui generis exception clauses respectively.

2.1 General exceptions clauses inspired by the WTO law

To this day, GECs that are either based on or incorporate the wordings of Article XX GATT and Article XIV GATS are prevailing in the practice of IIAs.[530]

These GECs are all very familiar and mostly differ in the permissible objectives under which the states' measures may be inconsistent with the IIA in question. It always depends on the arrangements of the particular states which can opt for a large list of exceptions depending on their economic backgrounds or keep the generally excepted objectives straight and simple.

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[528] Moldova, Republic of - United Arab Emirates BIT (2017), Article 12; Burundi - Turkey BIT (2017), Article 5; Mauritius-Pakistan (1997), Article 12.

[529] WALDE, Thomas, KOLO, Abba. Investor-State Disputes: The Interface Between Treat-Based International Investment Protection and Fiscal Sovereignty. *Intertax*,. 2007, 35(8/9), pp. 424–449. P. 431.

[530] SABANOGULLARI, Levent. *General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities*. Baden-Baden : Nomos, 2018. P. 67.

Usually, such GECs contain (apart from the *chapeau* and the nexus requirement) permissible objectives related to or necessary for "*protection of human, animal or plant life or health, or the environment; the conservation of living or non-living exhaustible natural resources; maintenance of public order,"* etc. [531]

Some of the BITs and FTAs even took the incorporation of the foregoing clauses a step further. Those IIAs do not contain the WTO's exceptions wording therein but rather opted for an incorporation thereof by reference.[532]

Lastly, it bares mentioning the CETA agreement which is also based on the WTO law. This agreement is deemed one of the most elaborated tools as regards affirming and securing the state's regulatory flexibility as well as the permissible objectives under the exceptions therein.[533]

2.2 Variedness of general exceptions clauses in some IIAs

Apart from the aforementioned IIAs, there are many others that contain sundry GECs not inspired by GATT or GATS the variety of which is enormous.

Such a vast divergence of the wordings of GECs among IIAs is on one hand understandable as all the states have different economical and legal backgrounds (not to mention the historical ones) as well as the objectives followed. On the other hand, however, the inconsistency is precisely the issue that might cause troubles over the time especially with such a new phenomenon as the GECs without any doubt are.

This Section thus provides with a peek into the matter by going through several specifically distinctive IIAs.

To begin with, Canada-Latvia BIT incorporated a convoluted combination of different exceptions throughout its wording. Firstly, there are Articles IV and VI entitled "*Exceptions*"

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[531] Burundi - Turkey BIT (2017), Article 5; Moldova, Republic of - United Arab Emirates BIT (2017), Article 12; Armenia - Latvia BIT (2005), Article 13.

[532] See, for example, EFTA-Costa Rica-Panama FTA (2013), Article 5.9, which reads:

"*With respect to the rights and obligations of the Parties concerning general exceptions, Article XIV of the GATS shall apply and is hereby incorporated into and made part of this Agreement, mutatis mutandis*."

Similarly, the case of the Trans Pacific Partnership Agreement (TPP) (2016), Article 29, and North American Free Trade Agreement (NAFTA), Article 2101.

[533] BALAŠ, Vladimír and ŠTURMA, Pavel. *Nové mezinárodní dohody na ochranu investic*. Praha : Wolters Kluwer, 2018. P. 40.

and "*Miscellaneous Exceptions*" respectively which for most part only exclude application of several articles to non-conforming measures, procurement, subsidies, or provide for possibility to derogate from intellectual property rights, while also completely exempting investments in cultural industries form the application of this BIT.[534]

On top of this, this BIT also contains Article XVII termed "*Application and General Exceptions*" which in fact partly incorporated the wording of Article XX GATT, but it also incorporated further permissible objectives. Moreover, the subsection 2. of this article contains a following wording: "*Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining or enforcing any measure otherwise consistent with this Agreement that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns*." Which, as implied before, is deemed merely "interpretive guidelines" without any particular significance and not the exceptions.[535]

Interestingly, there are several IIAs from the 90's which could be considered forerunners of the security and health exceptions in the contemporary GECs of IIAs. Those treaties usually include articles on prohibitions and restrictions which read

"*the provisions of this Agreement shall not in any way limit the right of either Contracting Party to apply prohibitions or restrictions of any kind or take any other action which is directed to the protection of its essential security interests, or to the protection of public health or the prevention of diseases and pests in animals or plants.*"[536]

Lastly, it seems worth mentioning the Russian approach to the matter of GECs and to conclusion of IIAs in general. It is worth mentioning not only due to the content but rather for the form in which it is regulated.

Historically, there were two model BITs issued by the Russian Federation – one in 1992, the second in 2001.[537] The treaties neither contained any general exceptions or even national

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[534] Canada-Latvia BIT (2009), Articles IV, VI.

[535] NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 509.

[536] See, for example, Mauritius-Pakistan (1997), Article 12; Egypt-Singapore (1997), Article 5.

[537] BROWN, Chester. *Commentaries on selected model investment treaties*. Oxford: Oxford University Press, 2013. P. 596 *et seq*.

security exception nor it exempted any policy areas (such as taxation, financial services, public procurement, or subsidies) from the scope thereof.[538]

However, in reaction to the latest developments Russian government issued Guidelines as of 30 September 2016 thereby specifically terminating the effect of both the Model BITs.

The Guidelines are intended to "*define the distinctivenesses of conducting negotiations and concluding international treaties of the Russian Federation on the promotion and protection of investments*".[539] In other words, instead of setting forth a rigid set of provisions the Guidelines are intended to provide the deputies with certain borders within which they may negotiate and conclude IIAs.

Contrary to the two Model BITs, the Guidelines contain several rather interesting provisions regarding the matter of exceptions specifically related to the "expropriation" provisions.

Firstly, Article 25 states that the expropriation provision should not cover security measures that are applied to the investor's investment by the investigative and judicial authorities of the party in which the investment was made.[540] Secondly, according to Article 26 expropriation provision should not apply to measures related to the establishment and collection of taxes and fees, provided those are neither arbitrary nor discriminatory. [541] Under Articles 28 and 29 Expropriation should not include customs regulations and compulsory licenses in respect of intellectual property. [542]

Finally, Article 27 considers events of natural disasters, accidents, epidemics, epizootics and other similar circumstances of an emergency nature in which the cases of requisition are also exempted from the application of the expropriation provision. However, in those cases it is specifically stated, that reimbursement is due with the restitution of an investment upon termination of the state of necessity.[543]

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[538] *Ibid*.

[539]ANON., 2019. [online] [accessed. 3 . November 2019]. Available at https://globalarbitrationreview.com/jurisdiction/1005360/russia#endnote-017.

[540] ANON., 2019. Постановление Правительства РФ от 30.09.2016 N 992 — Редакция от 30.09.2016 — Контур.Норматив. *Normativ.kontur.ru* [online] [accessed. 1 . December 2019]. Available at: https://normativ.kontur.ru/document?moduleId=1&documentId=281396.

[541] *Ibid.*

[542] *Ibid.*

[543] *Ibid*.

In conclusion, as has been demonstrated in tis Subsection the states have already approached the matter of incorporation of the GECs into their IIAs with a significant amount of creativity. Only the course of time and the prospective disputes will show how durable and effective these wording are.

3. APPROACH TO GENERAL EXCEPTIONS CLAUSES IN JURISPRUDENCE

Since the treaty practice regarding inclusion of the GECs into IIAs is quite recent, the ISDS practice has not had a proper opportunity to react thereto and thus produce a sufficient number of decisions which would satisfactorily resolve the above outlined questions. The more it relates to the application of such clauses in the cases of indirect expropriation.

In fact, the tribunals will be sooner or later in full brought before miscellaneous issues which stem from such a treaty practice. First and foremost, the investment tribunals will have to address the questions related to the delineation of what exactly is the relationship between GECs and other means of securing the state's right to regulate; more precisely the obligation-specific exceptions, IIAs' Annexes regarding indirect expropriation and the police powers doctrine. Alternatively, when taking into account what has been mentioned before, the tribunals will also have to decide upon the exact scope of applicability of the GECs; mostly with emphasizes on cases of indirect expropriation. Additionally, following the discussion on the relationship between the right to regulate and the duty to compensate, it is also far from clear whether the GECs will be interpreted as exempting the states from liability to compensate when adopting expropriatory measures; if affirmative, whether it would not disrupt the international investors' protection while shifting the current imbalance between the investors' and states' rights the opposite way.

Notwithstanding, as most of the IIAs that contain GECs incorporated those from or were inspired by the WTO's GATT or GATS, it seems rather worthwhile to mention key issues discussed within the WTO Panels' decisions concerning the matter.

Naturally, there are certain limitations to the application of the WTO's case law within the practice of the investment tribunals. Primarily, the investment law and trade law are utterly divergent spheres regulating dissimilar relationships.[544] After all, both the international trade and foreign direct investment are governed by different legal documents, they also differ in the

[544] TITI, Catharine. *The right to regulate in international investment law*. Baden-Baden : Nomos, 2014. P.178

nature of the rules and principles which they are based upon, while also having their own specialized dispute settlement systems.[545] Despite this, the WTO jurisprudence dealing with the GATT and GATS exceptions might be useful and relevant to the investment tribunals when interpreting such clauses in IIAs, more precisely when determining the ordinary meaning of the individual terms used therein.[546] In fact, several major investment cases to date have already referred to the jurisprudence of the WTO Panels and the Appellate Body at least to define a reading of national treatment or necessity requirement under an IIA.[547]

As regards the WTO's approach to the exception clauses, its case law adopted two stances thereon.[548] At first, for example, in *Canada-Ice Cream & Yoghurt* the Panel observed that not only "*a contracting party invoking an exception […] bore the burden of proving that it had met all of the conditions of that exception*" but also that those "*exceptions were to be interpreted narrowly*".[549] Similarly decided the Panel in the *EC-Meat Products*.[550]

However, the Appellate Body has found that such a narrow approach to the exceptions clauses does not correspond to the nature of the GEC.[551]

Followingly, in the two WTO cases *US-Shrimp* and *US-Gasoline* the Appellate Body concluded that a restrictive test applied in those cases by the Panels cannot find any support

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[545] LEGUM, Barton, and PETCULESCU, Ioana. Chapter 22: GATT Article XX and International Investment Law. In: ECHANDI, Roberto, SAUVÉ,Pierre. *Prospects in International Investment Law and Policy: World Trade Forum*. New York : Cambridge University Press Policy, 2013. Pp. 340-362. P. 351; SABANOGULLARI, Levent. *General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities*. Baden-Baden : Nomos, 2018. P. 219.

[546] MITCHELL, Andrew D., MUNRO, James and VOON, Tania. Importing WTO General Exceptions into International Investment Agreements: Proportionality, Myths and Risks. *Forthcoming, Yearbook of International Investment Law and Policy 2016-2017 ;U of Melbourne Legal Studies Research Paper.* Oxford : Oxford University Press, 2018, No. 757. P. 36; SUBEDI, P. Surya. *International investment law: reconciling policy and principle*. Oxford : Hart Publishing Ltd., 2016. P.186.

[547] KURTZ Jürgen*. The WTO and international investment law*. Cambridge : Cambridge University Press, 2016. P. 220, *et seq*.

[548] SABANOGULLARI, Levent. *General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities*. Baden-Baden : Nomos, 2018. P. 215.

[549] *Canada–Import Restrictions on Ice Cream and Yoghurt*, Panel Report, L/6568-36S/68, adopted on 5 December 1989, para. 59.

[550] *European Communities – Measures Concerning Meat and Meat Products,* Panel Report, WT/DS26/R/USA, adopted 18 August 1997, para. 4.253.

[551] *European Communities – Measures Concerning Meat and Meat Products*, Appellate Body Report, WT/DS26/AB/R and WT/DS48/AB/R, 16 January 1998, para. 104.

either within the wording of the *chapeau* or within the exceptions claimed.[552] Moreover, the Appellate body has also stressed the need for rather a balanced approach to the exceptions altogether as the broad possibility to invoke exceptions could disrupt the rights of the contracting parties protected under GATT.[553]

Speaking about the invocation of the exceptions, the WTO Appellate Body has also addressed the means of assessing the challenged measures under the exception clause.[554] According to the Appellate Body the scrutiny of the challenged measures is based on a two-prong test.[555] Firstly the challenged measures have to be assessed from the perspective of the justified exceptions listed in the subparagraphs of the GEC, i.e. fulfil the nexus requirement; secondly, these measures have to pass the "*chapeau* test" which exacts therefrom that they are not arbitrary or discriminatory.[556]

And as regards the nexus requirement, permissible objectives and other key terms commonly appearing in the GECs, the WTO bodies have issued several important decisions providing the interpretation thereof.[557] As the purpose of this thesis necessitates, the discussion will shortly stop by the jurisprudence regarding the interpretation of the nexus requirement for it was referred to on several occasions by the investment tribunals.

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[552] *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, Appellate Body Report, WT/DS58/AB/R, 12 October 1998, para 121; *United States – Standards for Reformulated and Conventional Gasoline*, Appellate Body Report and Panel Report WT/DS2/9, 20 May 1996, pp. 18-19.

[553] *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, Appellate Body Report, WT/DS58/AB/R, 12 October 1998, para 156.

[554] MITCHELL, Andrew D., MUNRO, James and VOON, Tania. Importing WTO General Exceptions into International Investment Agreements: Proportionality, Myths and Risks. *Forthcoming, Yearbook of International Investment Law and Policy 2016-2017 ;U of Melbourne Legal Studies Research Paper.* Oxford : Oxford University Press, 2018, No. 757. P. 18.

[555] GATT/WTO Dispute Settlement Practice Relating to GATT Article XX, Paragraphs (b),(d), and (g). Note by the Secretariat, WT/CTE/W/203, adopted on 8 March 2002, para. 9. *European Communities – Measures Prohibiting the Importation and Marketing of Seal Products*; Appellate Body Reports, WT/DS400/AB/R ; WT/DS401/AB/R, 22 May 2014, para. 5.169.

[556] *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan*, Appellate Body Report, WT/DS244/AB/R, 15 December 2003, para. 81; *United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, Appellate Body Report, WT/DS285/AB/R, 7 April 2005, para. 292; *European Communities – Measures Prohibiting the Importation and Marketing of Seal Products*; Appellate Body Reports, WT/DS400/AB/R ; WT/DS401/AB/R, adopted on 22 May 2014, para. 5.169.

[557] SABANOGULLARI, Levent. *General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities*. Baden-Baden : Nomos, 2018. P. 253.

Firstly, it is important to mention that, as the Panel also observed in *US – Gasoline*, "*it [is] not the necessity of the policy goal that [is] to be examined, but whether or not [the challenged measure] is necessary […]*"[558] Otherwise, the Panels (or, as the case may be, the investment tribunals) would subject to their scrutiny the state's internal processes resting in regulations of their internal policies which in turn would mean questioning the state's sovereignty by extrinsic entities.[559]

According to the GATT Secretariat, the "*necessity*" requirement has been introduced in the case *US-Section 337*[560] where the Panel stated that a challenged measure cannot be justified under Article XX if there is "*an alternative measure which it could reasonably be expected to employ and which is not inconsistent with the [other] provisions*." [561] Accordingly, it has observed that in order to comply with the necessity test the measures have to "*entail the least degree of inconsistency with the [other] provisions*."[562]

Additionally, the Appellate Body in *Korea – Various Measures on Beef* case has concluded that also the extent to which the challenged measure "*contributed to the to the realization of the end pursued*" shall be considered.[563]

Hence, the WTO Panels jointly with the Appellate Body have created a two folded test which in the first round balances the pursued objective and the measures adopted for its purpose; and in the second round it assesses whether the measures were capable to achieve such objective.[564]

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[558] *United States - Standards for Reformulated and Conventional Gasoline,* Panel Report, WT/DS2/R, adopted 29 January 1996, para 6.22.

[559] For the connotation of the term and further discussion see the Part "Right to Regulate and Indirect Expropriation" of this thesis.

[560] GATT/WTO Dispute Settlement Practice Relating to GATT Article XX, Paragraphs (b),(d), and (g). Note by the Secretariat, WT/CTE/W/203, adopted on 8 March 2002, para. 36.

[561] United States – Section 337 of the Tariff Act of 1930, Panel Report, 36S/345, adopted on 7 November 1989, para. 5.26.

[562] *Ibid*..

[563] Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef, Appelate Body Reports, WT/DS161/AB/R and WT/DS169/AB/R, adopted on para 10 January 2001. 163.

[564] SABANOGULLARI, Levent. *General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities*. Baden-Baden : Nomos, 2018. P. 265

Nevertheless, it is important to reiterate that the rigidity of this test will vary depending on the wording of the GEC at hand.[565]t

Moving to the decisions of the investment tribunals, several of them have already had recourse to the WTO case law regarding the matter. One of these was the tribunal in *Continental* deciding under the Argentina-United States BIT. More precisely, this tribunal has addressed the notion of "nexus requirement" and the applicability of the WTO case law within the ambit of international investment law. Before proceeding further, however, it is important to emphasize that this tribunal has dealt with the security exceptions within the circumstances of severe economic crisis and not with GEC which relates to the general welfare policies.[566]

As regards the nexus requirement, the tribunal primarily held that the WTO case law shall be drawn upon rather than customary international law due to the fact that the clause in question which contained the security exceptions was formulated similarly as the one contained in GATT.[567] The tribunal then proceeded with deliberation upon the necessity test for which it relied mostly on the decisions of the WTO Appellate Body and Panels (which are also discussed above).

Further, the tribunal in *S.D. Myers* has dealt precisely with the application of exceptions in the cases of the alleged expropriation.[568] In this case, the tribunal has found that even though

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[565] It will always depend whether the nexus requirement is expressed by the words "*necessary*", "*related to*" or other phrasing. Thus, for example, as regards the wording "*related to"* the GATT Panel in *Canada – Herring and Salmon* has there pointed out to the distinctive features of the GATT Article XX subparagraphs where some of them included the wording "*necessary*" of "*essential*" while subparagraph (g) included merely "*relating to*" which has to be taken into account;

Canada - Measures Affecting Exports Of Unprocessed Herring And Salmon, Panel Report, L/6268 - 35S/98, adopted on 22 March 1988, para. 4.6.

[566] *Continental Casualty Company v. The Argentine Republic,* ICSID Case No. ARB/03/9, Award, 5 September 2008, para. 181.

[567] *Ibid*., para. 192.

"With regard to the necessity test required for the application of the BIT, for the reasons stated above relating to the different role of Art. XI and of the defense of necessity in customary international law, the Tribunal does not share the opinion that "the treaty thus becomes inseparable from the customary law standard insofar as to the conditions for the operation of the state of necessity are concerned," as stated in the Enron Case and submitted also by the Claimant. Since the text of Art. XI derives from the parallel model clause of the U.S. FCN treaties and these treaties in turn reflect the formulation of Art. XX of GATT 1947,291 the Tribunal finds it more appropriate to refer to the GATT and WTO case law which has extensively dealt with the concept and requirements of necessity in the context of economic measures derogating to the obligations contained in GATT, rather than to refer to the requirement of necessity under customary international law."

[568] *S.D. Myers, Inc. v. Canada*, UNCITRAL, Partial Award, 13 November 2000, para. 289 *et seq*.

the GATT Article XX-like in the NAFTA Article 1410 provided for general exceptions regarding the reasonable measures related to the protection of investors, maintenance of safety, financial system and other permissible objectives, the ban on PCB exports nevertheless could not be justified.[569]

Finally, and most importantly, one of the latest decisions that has contributed to solving the issues of application of the GECs within the jurisprudence of the investment tribunals is one issued by the *Bear Creek* tribunal. Here, the tribunal has dealt with revocation by the means of enacting a Supreme Decree 083 of the authorization given to the Claimant in order to acquire, own and operate its mining concessions.[570] The representatives of Peru, the Respondent, have argued that such a measure could not be expropriatory as issuance of the Supreme Decree 083 was a legitimate exercise of the state's right to regulate under the police powers doctrine.

This argumentation, however, was not upheld by the tribunal. To the contrary, the tribunal held that since the GEC in Article 2201 of the Canada – Peru FTA had a conclusive list of permissible objectives and the Supreme Decree 083 did not fall under any of them, no additional exception could be applied in this case.[571]

Hence, the tribunal concluded that "*here is […] no need to enter into the discussion between the Parties regarding the jurisprudence concerning any police power exception for measures addressed to investments*."

It thus follows that the relationship between the GECs and the police powers doctrine could be deemed to be in accordance with the maxim *lex specialis derogat legi generali*. Hence, in cases of incorporation of the GECs into IIAs no additional permissible objectives will be recognized under the notion of the police powers doctrine. However, it needs to be reiterated

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[569] *S.D. Myers, Inc. v. Canada,* UNCITRAL, Partial Award, 13 November 2000, para. 298; in: NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 505.

[570] *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/21, Award, 30 August 2017, para. 149.

[571] *Ibid*. para. 473.

"*The Tribunal considers that already the title of Article 2201 "General Exceptions" shows that otherwise Chapter Eight (investment) remains applicable including its Articles 812 and, by the express footnote to the title of Article 812, as well as Article 812.1. Further, the list is not introduced by any wording (e.g. "such as") which could be understood that it is only exemplary. It must therefore be understood to be an exclusive list. Also in substance, in view of the very detailed provisions of the FTA regarding expropriation (Article 812 and Annex 812.1) and regarding exceptions in Article 2201 expressly designated to "Chapter Eight (Investment)", the interpretation of the FTA must lead to the conclusion that no other exceptions from general international law or otherwise can be considered applicable in this case*."

that the outcomes of the investment tribunals' decision-making process will always hugely depend on the exact wording of the GEC in question.

And even though the GECs are by nature intended to provide greater flexibility to the states in the exercise of their regulatory power, in this context, according to *prof. Newcome* "*it remains unclear whether general exceptions in fact provide greater regulatory flexibility for host state measures that affect foreign investment and investors*."[572]

[572] NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 505.

CONCLUSION

In the course of the research related to the matters addressed by this thesis it became clear that before proceeding to respective answers to the research questions set in the beginning of the thesis it is necessary to mention several important issues common for all the concepts discussed above.

Firstly, what has been encountered throughout the research is a highly inconsistent terminology not only as regards the concept of indirect expropriation and its subcategories but also different aspects of the state's right to regulate as well as the GECs. Thus, the first step is to stop labelling and opt for a comprehensive and uniform approach which would work with the content of the notions related to the matter. This would be possible to achieve by a complex set of guidelines which would be created by the scholars and arbitrators from different jurisdictions.

Furthermore, which is partly related to the previously mentioned issue, is the terminological inconsistency within the treaty practice. One for all, the "nexus requirement" fully encompasses this problem. As has been discussed in the last Part of this thesis, in order for the measures to be protected under the GEC they have to fall under one of the permissible objectives included therein while fulfilling the nexus requirement. However, the rigidity of the wordings which embody this requirement is very divergent (sometimes this requirement is absent at all) which in prospective disputes would lead to very inconsistent rulings.

In addition, what seems the most troublesome is the decision-making practice of the investment tribunals. It is utopian to expect that the tribunals would be deciding all the claims similarly for they are limited by the respective IIAs and thus the discrepancies in the investment arbitration practice are inevitable. However, it is not that unreasonable to expect the tribunals to make their decisions carried out in a mutually coincident manner – at least when applying different tests for assessment of indirect expropriation.

Based on the foregoing, the concluding remarks will now address the research questions.

<u>QUESTION 1</u>: ***Which method shall be applied by international investment tribunals in the scrutiny of the challenged state's measures in cases of indirect expropriation?***

Setting aside any labelling and word-splitting a substantive question is – how shall the tribunals approach the challenged regulatory measures?

From the foregoing, it appears that the tribunals have already partly answered this question by including more aspects into their consideration of the indirect expropriation cases. Essentially, the method to be applied has to be founded on a "step-by-step" test consisting of separation and gradual assessment of different aspects of the case.

Following the tests introduced by *Paulson & Douglas* or by *Isakoff*,[573] the proper method of assessment would comprise of the following steps.

Primarily, the tribunals shall scrutinize the effect which the challenged measures had on the respective investor. If the effect is found to be substantial enough, the tribunal proceeds with the second step, otherwise it dismisses the claim.

In the second step shall be applied the police powers doctrine where the purpose of the challenged measures would be taken into consideration.

As the third step shall be applied the proportionality test which requires that the measures are closely related to the pursued legitimate policy, capable of reaching such and the least restrictive of the possible measures. By which the notion of the police powers doctrine will be proportionally restricted to a genuine legitimate and necessary exercise of the regulatory activity.

Lastly, it seems also apposite to also consider any commitments that the state has undertaken towards the investors in question, i.e. the legitimate expectations of investors.

It is, however, important to reiterate, that such a test cannot stem from a practice of the investment tribunals. As was concluded in *SGS case "There is no hierarchy of international tribunals, and even if there were, there is* ***no good reason for allowing the first tribunal in time to resolve issues for all later tribunals.***" Thus, introduction of such a test rests rather with the doctrine.

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[573] See MONTT, Santiago. *State Liability in Investment Treaty Arbitration; Global Constitutional and Administrative Law in the BIT Generation*. 2012. Oxford and Portland : Hart Publishing. P. 236; ISAKOFF, Peter David. Defining the Scope of Indirect Expropriation for International Investments. *Global business law review*. 2013, 3(2), pp. 189-209. P. 204.

QUESTION 2: ***What are the possible means the states can utilize in pursuance of recalibration of the relationship between their regulatory flexibility and investors' protection?***

Apart from the GECs which will be addressed immediately afterwards, it seems that states do have at least one other mean of protecting their regulatory flexibility within the ambit of the international investment protection.

Given that IIAs represent the fundamental source of the decision-making practice of international investment tribunals while also limiting its scope, the states have a great possibility to influence the outcomes of such practice by formulating clearer rules and definitions of the ambiguous concepts and terms included therein.

Hence, the latest practice of including explanatory provisions or annexes concerning the "expropriation" clauses seems very convenient and least invasive way to reintegrate the balance between the public and private rights into the investor-state relationship. Moreover, these provisions often set forth the applicable method of the indirect expropriation assessment.[574]

Unfortunately, many states (especially the ones against which no claim has been yet brought before international investment tribunals) opted for generic, i.e. less elaborated, treaty wordings leaving the faith of their regulatory flexibility solely to the discretion of the investment tribunals.

QUESTION 3: ***Do the GECs have any practical applicability within the ambit of international investment law?***

At the time being, it still remains unclear whether inclusion of the GECs reaffirms and strengthens the states' regulatory powers or, in fact, imposes limitations thereupon.[575]

Based on the recent decision of the *Bear Creek* tribunal, it seems, that the GECs, if drafted exhaustively with no space for the tribunals' discretion, would be perceived as rather limiting in comparison with the police powers doctrine.[576]

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[574] See, for instance, China – Republic of Korea FTA (2015), Annex 12-B; Australia – Indonesia CEPA (2019), Annex 14-B; Argentina – Japan BIT (2018), Art. 11, Section 3; China – United Republic of Tanzania BIT (2013), Art.6.

[575] NEWCOMBE, Andrew and PARADELL, Lluis. *Law and practice of investment treaties standards of treatment.* Alphen aan den Rijn : Kluwer Law International, 2009. P. 505.

[576] *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/21, Award, 30 August 2017, para. 473.

Moreover, due to their nature, the GECs are essentially prone to a mala fide invocation which suggests that the investment tribunals shall remain a prudent and thoroughgoing approach in the assessment of cases where the states claim their measures to be covered by the exceptions clause.[577]

In conclusion, international investment law is yet to elaborate a clear stance towards the phenomenon of the GECs. Followingly, only time and decision-making practice of the investment tribunals will show whether this operation residing in transplantation the trade law GECs into the body of international investment law was indeed a successful campaign.

[577] SABANOGULLARI, Levent. *General exception clauses in international investment law: the recalibration of investment agreements via WTO-based flexibilities*. Baden-Baden : Nomos, 2018. P. 171 *et seq*.

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International Investment Agreements		
Official Title	***signed***	***force***
Algeria - Russian Federation BIT (2006)	10/03/2006	--
Argentina - Greece BIT (1999)	26/10/1999	--
Argentina - Japan BIT (2018)	01/12/2018	--
Argentina - Qatar BIT (2016)	06/11/2016	--
Armenia - Latvia BIT (2005)	07/10/2005	21/04/2007
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